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The Inherent Paradox

Regional Trade Agreements in International Trade Law

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Contents

Summary

The framework for regional trade agreements permits customs unions and free trade agreements to derogate from the Most Favoured Nation-principle provided that a number of conditions are fulfilled: internal requisites safeguarding internal market liberalization and external requisites, calling for harmonization of external trade policies and preventing the raising of barriers in relation to third countries. Investigating the framework, this thesis attempts to establish valid interpretations of key elements insofar possible and discusses possible solutions to the ambiguous criteria. Moreover, the extent of the regional trade agreement exception and its relation to other GATT/WTO-obligations is investigated.

Regarding the internal requirements, the thesis finds that in addition to tariff duties also border measures ought to be included in the internal market liberalization requirement. Internal measures may also qualify, depending on their effect. The parties have a wide margin of discretion in deciding to the trade of what products the agreement is applicable. No valid interpretation of the criterion for degree of market liberalization can be established in lack of preparatory work and subsequent agreements addressing the issue as well as consistent practice in application. However, a certain degree of reciprocity in this regard appears to be required. Qualitative as well as quantitative approaches have been proposed as solutions to this dilemma. The thesis suggests that they should be applied in combination.

Regarding the external requirements, the thesis finds that the extent of these rules is wider compared to the internal requirements, and suggests a dynamic interpretation, essentially setting the extent of these rules in relation to the coverage of the agreement. Moreover, the thesis establishes that the flexibility in the requirement for harmonization of common external trade regimes of customs union is severely limited. The prohibition on raising barriers in relation to third countries should be interpreted as entailing an economic test. The temporal requirement for implementation of interim agreements allows for exceptions, but should as a main rule be interpreted as a binding 10-year requisite.

Regarding the relation between GATT Article XXIV and other GATT/WTO obligation the thesis affirms that regional trade agreements legitimately can derogate not merely from the Most Favoured Nation-principle but also from other multilateral undertakings provided that the measure was introduced at the formation of the agreement and that the formation would be prevented if the measure was not allowed. Case law sets the threshold for the latter requisite remarkably low. It also affirms that the regional trade agreement party bears the burden for showing that these requisites are fulfilled, once the complaining party has established a prima facie violation of a GATT/WTO obligation.

Sammanfattning

Regelverket för regionala avtal tillåter tullunioner och frihandelsavtal att göra avsteg från mest gynnade nations-principen förutsatt att ett antal villkor uppfylls; interna rekvisit som säkerställer liberalisering av den inre marknaden och externa rekvisit som syftar dels till harmonisering av yttre handelspolitik och dels till att förebygga att hinder reses mot tredje land. Genom undersökning av detta regelverk söker denna uppsats så långt möjligt fastställa giltiga tolkningar av nyckelelement och diskuterar möjliga lösningar på oklara kriterier. Därutöver undersöks omfånget för undantaget för regionala avtal och dess relation till andra GATT/WTO-skyldigheter.

Rörande de interna villkoren fastslår uppsatsen att villkoret om att liberalisera den inre marknaden förutom tullar också inkluderar gränsåtgärder. Interna åtgärder kan också ingå, beroende på deras effekt. Parterna har stort rörelseutrymme i valet av vilka produkter som skall omfattas av avtalet. I frånvaro av uttalanden i förarbeten, senare avtal och enhetlig tillämpningspraxis kan ingen giltig tolkning av villkoret om liberaliseringsgrad fastställas. En viss grad av reciprocitet verkar emellertid krävas. Det har presenterats såväl kvalitativa som kvantitativa förslag till att lösa detta problem; uppsatsen föreslår att de bör tillämpas i kombination.

Rörande de yttre villkoren fastslår uppsatsen att omfånget av dessa regler är bredare jämfört med de interna villkoren. En dynamisk tolkning föreslås, där reglernas omfång ställs i relation till avtalets omfattning. Vidare konstateras att flexibiliteten i villkoret om harmonisering av yttre handelspolitik för tullunioner är kraftigt begränsad. Förbudet mot att resa hinder mot tredje innebär ett ekonomiskt test. Det tidsmässiga villkoret för implementering av interimsavtal tillåter undantag, men skall som huvudregel tolkas som en bindande tioårsregel.

Rörande relationen mellan GATT Artikel XXIV och andra GATT/WTO-skyldigheter fastslår uppsatsen att regionala avtal kan göra legitima avsteg, inte bara från mest gynnade nations-principen men också från andra multilaterala åtaganden, förutsatt dels att åtgärden introducerats vid bildandet av det regionala avtalet och dels att bildandet hade omöjliggjorts om inte åtgärden tillåtits. Praxis sätter nivån för det senare villkoret förvånansvärt lågt. Praxis fastslår också att det är parten till det regionala avtalet som bär bördan för att visa att nödvändiga rekvisit är uppfyllda när klagande part prima facie etablerat en överträdelse av GATT/WTO-åtagande.

Abbreviations

EEC	European Economic Community
EU	European Union
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
VCLT	1969 Vienna Convention on the Law of Treaties
WTO	World Trade Organization

1 Introduction

Customs unions and free trade agreements constitute paradoxes in international trade law. Conditions are set up for their establishment in GATT[1], the most basic framework of international trade law. Thus, free trade agreements and customs unions have seemingly been given a place in an ordered system, their relationship to the multilateral trading system being made clear. Yet on the same time, free trade agreements and customs unions undermine the most basic foundations of the GATT and international trade law as a whole, in three ways.

Firstly, customs unions and free trade agreements deviate from the most fundamental principle of international trade law, that of non-discrimination, effectively rendering the obligation to offer other members of the WTO the most favoured treatment into an obligation to offer the second-, third- or fifty-ninth-best treatment, depending on how many free trade agreements or customs unions with more generous conditions a member has entered into.

Secondly, for third countries it is only possible to object to the formation of a customs union or free trade areas when it discriminates against only a portion of their external trade; when it discriminates against substantially all of their trade they are compelled to accept the agreement. Whereas the spirit of the remainder of GATT aims to prevent discrimination, the legal framework for free trade agreements and customs union requires the greatest possible discrimination for third countries relative to the parties.

Thirdly, customs unions and free trade agreements increasingly form undertakings not merely relating to tariff liberalization but also other trade policy areas. This creates more differentiated terms for trade and as a consequence, also other GATT/WTO obligations than the *Most favoured nation*-principle risk being undermined by customs union or free trade agreement undertakings.

This thesis will examine the framework for regional trade agreements in international trade law, investigating insofar possible what requirements states actually must fulfil when establishing or participating in free trade areas or customs unions. Moreover, possible solutions will be discussed in cases where no valid interpretation can be established. In this part, the

[1] General Agreement on Tariffs and Trade 1994, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, The Legal Texts: The Results of the Uruguay Round of Multilateral Trade Negotiations 17 (1999), 1867 U.N.T.S. 187, 33 I.L.M. 1153 (1994) [hereinafter GATT 1994]. GATT 1994 constitutes a modification of the original GATT text (GATT 1947). However, no provision relevant for the subject of this thesis was altered during the modification of the GATT.

investigation will be divided between requirements on internal market liberalization, on the one hand, and requirements relating to outside states, on the other.

Moreover, the relationship between these agreements and the broader multilateral trading system will be subject to discussion; in a system of international trade law where an increasing number of bilateral agreements regulate the same issues as the multilateral treaties, to what extent can customs unions and free trade agreements legitimately derogate from the GATT and other WTO agreements? In other words, what does international trade law require for the formation of a customs union or free trade area, and, once such an agreement has come into existence, how does its undertakings relate to similar undertakings in multilateral rules?

Both the trade in goods agreement and the trade in services agreements of the WTO, the GATT and the GATS[2] contain provisions on customs unions and free trade agreements, Article XXIV and V respectively. Although drafted in a similar manner, the rules contain differences. GATS Article V especially diverges from GATT Article XXIV with regards to the requirements for internal market liberalization.[3] Moreover, the Enabling Clause[4] contains special rules on customs unions and free trade agreements where all parties are developing countries (sometimes referred to as south-south agreements). The Enabling Clause sets up conditions that are less demanding and less specific compared to those provided for in Article XXIV of the GATT. With the exception of a general obligation not to enter into agreements based on protectionist concerns, the freedom of contract is not constrained for developing countries when negotiating customs unions or free trade agreements.[5]

[2] General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, The Legal Texts: The Results of the Uruguay Round of Multilateral Trade Negotiations 284 (1999), 1869 U.N.T.S. 183, 33 I.L.M. 1167 (1994) [hereinafter GATS].

[4] The Decision of the GATT Contracting Parties of 28 November 1979 on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries, commonly referred to as the "Enabling Clause". [hereinafter Enabling Clause].

[5] The Enabling Clause provides, in its first paragraph, a general exception from the *Most Favoured Nation*-principle in GATT Article I for, among other cases, customs unions and free trade agreements entered into amongst developing countries, according to its paragraph 2(c). According to its third paragraph, the only requirement for customs unions and free trade agreements between developing country members is that such agreements "*shall be designed to facilitate and promote the trade of developing countries and not to raise barriers to or create undue difficulties for the trade of any other*."

Rather than exploring customs unions and free trade agreements relating to trade in goods and trade in services in parallel, as well as the special rules for such agreements where all parties are developing countries, this thesis has a single point of departure: the fundamental rule on customs unions and free trade agreements in GATT Article XXIV. Accordingly, the scope of the investigation will be limited to "traditional" customs unions and free trade agreements relating to trade in goods, excluding trade in services agreements as well as the special rules for developing countries. Arguably, an investigation of GATT Article XXIV is more relevant since the number of trade in goods agreements outnumbers trade in services agreements. Moreover, no *trade in services*-free trade agreement between two or several states has been notified without the existence of a corresponding trade in goods component, whether in the same or a pre-existing treaty.[6] It should however be noted that an analysis of *trade in services*-free trade agreements in many cases would yield the same results as the examination in this thesis. Likewise, parts of the conclusions in this thesis are relevant for agreements between developing countries, namely the analysis relating to GATT Article XXIV:4, since this paragraph is almost identically reiterated in the Enabling Clause's sole legal requirement on agreements between developing countries.

[6] Merely one agreement has been notified to the WTO solely on the basis of GATS Article V, the European Economic Area of 1994. This agreement only complemented the pre-existing EC Treaty dating back to 1958.

2 The framework for regional trade agreements

In WTO law, customs unions and free trade agreements, collectively referred to as regional trade agreements, are regulated in parallel. The central and common feature to such agreements is that the parties offer each other to trade on more generous conditions relative to other trading partners. Conversely, the non-members to the regional trade agreement are put in a comparatively worse-off situation. Thereby, regional trade agreement creates more differentiated terms of trade. To the extent the outsiders are WTO members, the discrimination that they face as the result of the regional trade agreement is inconsistent with one of the most fundamental principles of WTO law, the *Most Favoured Nation*-treatment obligation. According to this obligation, any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.[7] Seemingly, entering into agreements with the implicit aim of discriminating other trading partners would be in direct contrast with this principle.

So, does such deviation from the *Most Favoured Nation*-principle, which is the result of the formation of the regional trade agreement, constitute a violation of WTO law? Can WTO members be held accountable for violating treaty obligations, by striking discriminatory agreements with some – but not all – other members? The answer is – in most cases - no. The *Most Favoured Nation*-principle is subject to – or, some would say, undermined by - a major exception. *The framework for regional trade agreements*, found in Article XXIV of the GATT and connecting provisions allows for WTO members to relatively freely, albeit subject to limitations; enter into such agreements without side-stepping WTO treaty obligations.[8] One observer has explained the framework for regional trade agreements as setting the multilateral constitutional limits within which regional trade agreements can manoeuvre.[9] In this manner, the framework for regional trade agreements also erodes the freedom of contract for GATT parties to conclude trade agreements with some, but not all, GATT parties.

[7] GATT 1994 Article I.

[8] It follows, albeit not expressly, from the chapeau of GATT Article XXIV:5 ("*the provisions of this agreement(…)shall not prevent the formation of a Customs union or Free Trade Area*") that customs unions and free trade agreements are exceptions from the *Most Favoured Nation* -principle of GATT Article I. The permission to derogate from Most Favoured Nation is conditional, as it presupposes the fulfilment of necessary criteria in GATT Article XXIV.

[9] Devuyst, Y. and Serdarevic, A., "*The World Trade Organization and Regional Trade Agreements: Bridging the Constitutional Credibility Gap*", Volume 18:1 Duke Journal of

In this thesis, the requirements and exceptions of the framework for regional trade agreements and its complex relationship to other WTO obligations will be examined. However, derogating from other WTO obligations based on the *regional trade agreement*-exception presupposes the fulfilment of certain requirements. These requirements, found in the definition of free trade areas and customs unions will form the starting point for our investigation. In this section we will also discuss the difference between free trade agreements and customs unions. Although regulated in parallel and in many cases subject to identical rules, the framework makes a distinction between free trade agreements and customs unions.

Comparative & International Law, USA (2007) [hereinafter Devuyst and Serdarevic (2007)], p. 4.

3 Free trade agreements and customs unions - definition and distinction

Both free trade agreements and customs unions are defined in GATT Article XXIV:8.

> *(a) A customs union shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that*
> *(i) duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated with respect to substantially all the trade between the constituent territories of the union or at least with respect to substantially all the trade in products originating in such territories, and,*
> *(ii) subject to the provisions of paragraph 9, substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union;*
> *(b) A free-trade area shall be understood to mean a group of two or more customs territories in which the duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated on substantially all the trade between the constituent territories in products originating in such territories.*

Seemingly similar, the rules defining customs unions and free trade areas in GATT Article XXIV:8 set up conditions in two regards; firstly, to what extent trade restrictions between the members has to be abolished, and, secondly, regarding whether and/or to what extent the members should apply the same trade conditions in relation to non-members. In other words, the definition is based on two parameters; the first one regarding amount of *internal market liberalization*, the second one relating to degree of likeness in *external trade policy*. It is also in these two regards the framework differentiates between free trade areas and customs unions. Whereas requirements relating to internal market liberalization are set up for both customs unions and free trade areas, requirements relating to external trade policy are confined to customs unions.

The definition, as such, is absolute. Yet it is based on relative terms. This is essentially what makes it problematic. Defining these instruments by setting up conditions in imperative terms, a converse reading of the rule makes clear that an agreement falling short of fulfilling these requirements is not a free trade area or customs union by virtue of the GATT. Accordingly, this thesis would argue, an agreement that fails to qualify as a customs union or a free trade area according to the definition cannot provide a basis for derogation from the *Most Favoured Nation*-principle or other GATT obligations. However, as we shall find out, from the rules it is far from clear where on the scales the thresholds for fulfilling these requirements are set, *i.e.* what levels of internal market liberalization and harmonization of external trade policy are binding. We shall now endeavour to clarify these requirements, starting with the internal requisites.

4 Trade conditions in between the members

4.1 Requirement for internal market liberalization in free trade areas and customs unions

Whereas other obligations in the Framework for regional trade agreements, such as the ban on putting third-countries in a worse off situation, are, as we later shall see, formulated as obligations for customs unions and free trade areas, the requirement for internal market liberalization is not simply an obligation which customs unions and free trade areas ought to adhere to. Placed at the heart of the definition of customs unions and free trade areas, the liberalization of internal trade is what more than anything else distinguishes these instruments. A converse reading of Article XXIV:8 makes clear that an alleged, claimed or declared customs union or free trade area which fails to liberalize its internal trade sufficiently, is in fact not a customs union or free trade area, according to the GATT definition.

Moreover, the fact that the requirements for internal market liberalization are included in the definition suggests that it is paramount to obligations outside of paragraph 8 relating to regional trade agreements. Accordingly, a proclaimed customs union or free trade area that fails to sufficiently liberalize its internal trade cannot legitimately claim the benefits of the *regional trade agreement*-exception. A regional trade agreement that fails to meet a GATT Article XXIV obligation outside of the definition in paragraph 8, on the other hand, would still remain to be a customs union or free trade area. That is to say, such an agreement would violate a GATT obligation in part, but would nevertheless form a valid agreement.

As we see, the requirement for internal market liberalization is regulated in parallel for customs unions and free trade areas. Common to both free trade areas and customs unions, one could divide the requirement for internal market liberalization into two requisites or variables; the first one being *subject for market liberalization* (what trade should be liberalized and what measures ought to be eliminated?), the other one being *degree of market liberalization* (to what extent should the trade be liberalized and the measures eliminated?). Taken together, the requirement for internal market liberalization works as a function between the two variables and could be pictured as the x- and y-axis in a simple two-dimensional coordinate system. Whereas the criterion on degree of market liberalization (“substantially all”) is common to both customs unions and free trade areas, the *subject* for this liberalization differs somewhat between the two instruments.

We shall now attempt to clarify what ought to be included in the subject for market liberalization before discussing to what degree this subject is to be liberalized.

4.1.1 Subject for market liberalization

The dissimilarity between the internal market liberalization requirement for customs unions and free trade areas lies in the *subject* for this liberalization, or, in other words, what it is that substantially all of ought to be liberalized. The requisites are provided in Article XXIV:8 (a)(i) for customs unions and (b) for free trade areas.

8. For the purposes of this Agreement:

> *(a) A customs union shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that*
> *(i) duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated with respect to substantially all the trade between the constituent territories of the union or at least with respect to substantially all the trade in products originating in such territories, and,*
>
> *(…)*
>
> *(b) A free-trade area shall be understood to mean a group of two or more customs territories in which the duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated on substantially all the trade between the constituent territories in products originating in such territories.*

For both customs union and free trade areas, Article XXIV:8 (a)(i) and (b) makes clear that the duty to abolish internal restrictions do not extend to certain measures which explicitly are allowed for in Articles XI to XV and under Article XX of the GATT.[10] After this clarification, the two rules diverge. In a customs union, it is *the duties and other restrictive regulations of commerce* with respect to either (1) *trade between the constituent territories of the union* or (2) *at least trade in products originating in such territories* which ought to be liberalized. Two alternative subject rules are thus provided, rule (2) formulated as an optional resort. For free trade areas it is *the duties and other restrictive regulations of commerce* on *trade between the constituent territories in products originating in such territories* that forms the subject for internal market liberalization. The subject rule for free trade areas thus corresponds to the option (2) for customs union, whereas the optional and more ambitious option (1) is lacking. Before venturing into the differences between the subject rules for the two instruments we will examine the term common to both rules; *duties and other restrictive regulations of commerce.*

4.1.1.1 Duties and other restrictive regulations of commerce

Common to customs unions and free trade areas is that the subject for the internal market liberalization requirement according to Article XXIV:8(a)(i) and (b) includes *tariff duties* as well as *other restrictive regulations of commerce.* The coverage of these terms is to a large extent an open question. Neither any panel nor the Appellate Body has endeavoured to define the terms. Moreover, the terms have been subject to extensive discussion among WTO Members.[11] An agreement on definition, however, is yet to be reached.

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[10] These relate to, firstly *certain import and export restrictions in the agricultural sector, such as those to support domestic supply management regimes*, which otherwise would be unlawful according to the *General Elimination of Quantitative Restrictions* in GATT Article XI. Secondly, GATT Article XII explicitly permits import restrictions in the event of balance of payments emergencies. Thirdly, GATT Article XIII on *Non-Discriminatory Administration of Quantitative Restrictions* requires that in those areas where quotas are allowed (for instance, agriculture) quotas be applied on a non-discriminatory basis. Fourthly, GATT Article XIV on *Exceptions to the Rule of Non-discrimination* allows deviation from the non-discriminatory application of quotas under article XIII if necessary for balance of payments reasons. Fifthly, GATT Article XV on *Exchange Arrangements* allows deviation from GATT rules to comply with commitments to the International Monetary Fund. Sixthly (and lastly), the *General Exceptions* in GATT Article XX allows qualified deviation from GATT rules for measures to protect health, safety, the environment. See Hudec, R. E. and Southwick, J. D., "*Regionalism and WTO Rules: Problems in the Fine Art of Discriminating Fairly*" in Mendoza, M.R., Low, P., Kotschwar, B. (eds.), "*Trade Rules in the Making; Challenges in Regional and Multilateral Negotiations*", General Secretariat/Organization of American States, Brookings Institution Press, Washington D.C, USA (2003), p 63.

[11] Lockhart, N.J.S., and Mitchell, A.D.,"*Regional Trade Agreements under GATT 1994: An Exception and its Limits*" in Mitchell, A.D. (ed.), "*Challenges and Prospects for the WTO*", Cameron May Ltd., United Kingdom (2005) [hereinafter Lockhart and Mitchell (2005)], p. 236.

However, some guidance in the interpretation of this criterion could be provided by treaty interpretation rules. In *Turkey Textiles*, the Panel established that principles of interpretation of public international law should guide the examination of Article XXIV, in accordance with Article 3.2 of the WTO Memorandum of Understanding of the WTO's Dispute Settlement Understanding[12]. The Appellate Body did not overrule this conclusion.[13] Thereby, there is indeed support in case law for a closer treaty interpretation of the *subject for market liberalization*-criterion.

The central rules of treaty interpretation are found in Section 3 of the 1969 Vienna Convention on the Law of Treaties.[14] Article 31(1) of the Vienna Convention on the Law of Treaties provides that "*A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.*" Based on this rule, it is clear that defining customs duties isn't the major problem, its meaning being defined elsewhere in the GATT.[15] Rather, the difficulty lies in defining what a *regulation of commerce* is, according to Article XXIV:8, and, once such a definition has been obtained, what sort of duties and regulations are to be characterized as *restrictive*.

Although most regulations curtail trade in one way or another, at least by increasing administrative burdens, the inclusion of the word *restrictive* indicates that the rule does not recognize all regulations as restrictive. Moreover, according to Article XXIV:8, such restrictive regulations do not need to be eliminated on all trade, but merely on trade between the constituent territories. One can thereby draw the conclusion that merely regulations restricting cross-border movement of goods within the regional trade agreement are covered by the requirement for internal market liberalization. Interpreting the term teleologically, one observer has concluded that the goal of the rule is to create a market among the parties that is border-free rather than regulation-free.[16] This view excludes

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[12] Understanding on Rules and Procedures Governing the Settlement of Disputes, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, The Legal Texts: The Results of the Uruguay Round of Multilateral Trade Negotiations 354 (1999), 1869 U.N.T.S. 401, 33 I.L.M. 1226 (1994) [hereinafter Dispute Settlement Understanding].
[13] Appellate Body Report, "*Turkey - Restrictions on Imports of Textile and Clothing Products*" (WT/DS34/AB/R) (22 October 1999) [hereinafter Appellate Body Report, Turkey Textiles], Panel Report, "*Turkey - Restrictions on Imports of Textile and Clothing Products*" (WT/DS34/R) (31 May 1999) [hereinafter Panel Report, Turkey Textiles], para. 9.91, p. 124.
[14] United Nations, Vienna Convention on the Law of Treaties (23 May, 1969) 1155 U.N.T.S. 331, 8 I.L.M. 679 [hereinafter Vienna Convention on the Law of Treaties].
[15] Customs duties relates to duties on imported products that are applied at the border, *i. e.* measures applied on products in connection with border passage. Such measures are primarily regulated in GATT Article II. Duties are typically imposed either in order to safeguard government revenues or to restrict import of foreign goods for the purpose of protecting domestic producers. Thereby, duties are restrictive regulations of commerce *per se*.
[16] Lockhart and Mitchell (2005), p. 237.

everything but *border restrictions* from the coverage of the requirement for internal market liberalization. These include import bans, quantitative restrictions, administrative rules regulating importation, sanitary and phytosanitary measures prohibiting imports. Most likely, marketplace regulations that adversely affect imported goods but not domestic goods would also be included. Whether trade remedy measures ought to be included appears unclear.[17] Safeguard measures between members of a regional trade agreement appear to be allowed for according to case law.[18] However, other observers have disputed the suggestion that everything but border restrictions ought to be excluded. One observer wanted to expand the scope of the terms, agreeing that border measures are other restrictive regulations of commerce *per se*, but claiming that also internal measures might be encompassed by *other restrictive regulations of commerce*. In this context, the same observer discussed whether technical barriers to trade and sanitary and phytosanitary measures ought to be included, finding that it would be absurd to include *all* such measures; rather, certain such measures ought to be included, namely those that are discriminatory or perhaps also unnecessary.[19]

Accordingly, another observer has proposed an interpretation of *other restrictive regulations of commerce* including not merely border measures but also domestic regulations (fiscal or non-fiscal) which accord less favourable treatment to like imported products of the regional members.[20] In sum, it is clear that tariff duties falls within the internal market liberalization requirement. It seems more difficult to arrive at a conclusive interpretation of the terms *other regulations of commerce.* Some guidance can be provided by the ordinary meaning of the terms as well as its object and purpose, but no subsequent agreement or practice has established an interpretation of this criterion. It appears to be clear that border measures are included. Internal measures may also qualify, depending on their effect.

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

[18] The Panel in Argentina – Footwear assumed that safeguard measures are 'duties and other restrictive regulations of commerce' under Article XXIV:8: paras 8.96–8.97. The Appellate Body reversed the Panel's findings on Article XXIV: Appellate Body Report, Argentina – Footwear (EC), para 110. However, this aspect of the Panel's findings on Article XXIV was not examined by the Appellate Body nor specifically declared to be an erroneous interpretation of Article XXIV:8. See Appellate Body Report, "*Argentina – Safeguard Measures on Imports of Footwear* (WT/DS121/AB/R, 14 December 1999) [hereinafter Appellate Body Report, Argentina –Footwear] and Panel Report "*Argentina – Safeguard Measures on Imports of Footwear*" (WT/DS121/R, 25 June 1999) [hereinafter Panel Report, Argentina –Footwear].

[19] Trachtman, J.P., "*Toward Open Recognition? Standardization and Regional Integration Under Article XXIV of GATT*", Tufts University, Medford, Massachusetts, USA (2002), p. 26.

[20] Mathis. J.H., "*Regional Trade Agreements and Domestic Regulation: What Reach for 'Other Restrictive Regulations of Commerce'?*", p. 91 in Bartels, L. and Ortino, F., "*Regional Trade Agreements and the WTO Legal System*", Oxford University Press, United Kingdom (2006) [hereinafter Mathis (2006)].

The difficulties in deciding the coverage of the subject for the market liberalization requirement does however not end with defining what measures ought to be included; one also needs to decide in relation to the trade of what products this duty relates.

4.1.1.2 Free trade areas – trade in products originating in a member country

Apart from the difficulties in defining what constitutes *other restrictive regulations of commerce* the rule for free trade areas is seemingly relatively unambiguous whereas subject is concerned. Custom duties and other restrictive regulations of commerce should be eliminated on substantially all the trade between the constituent territories in products *originating in such territories*.[21] The reason why the internal trade liberalization requirement is limited to products *originating* in the free trade area rather than all products circulating within the free trade area is that an absolute requirement for internal market liberalization would prevent any individual free trade area party from maintaining any higher tariff duty or restriction, in comparison with another party.

Without such an exception for products originating outside the free trade area, all comparatively higher regulations could be circumvented by importing a product into another country of the free trade area and then freely circulate it within the free trade area. The result would be that all but the most beneficial regulations for importers would be undermined, an effect referred to as trade deflection.[22] Essentially, in lack of a rule preventing such trade deflection the free trade parties would eventually be forced to harmonize external trade restrictions, thus becoming a customs union. Hence, the limitations of free circulation in a free trade area to products originating therein are what uphold the individual free trade area parties' ability to pursue individual external trade policies.

However, implementing the rule effectively also requires a way of proving what products qualify for the free circulation within the free trade area. In particular, it highlights the importance of preferential rules of origin. Preferential rules of origin are not subject to the general obligations in the Agreement on Rules of Origin, although they are subject to certain transparency requirements in the Common Declaration with Regard to Preferential Rules of Origin in Annex II of that Agreement. [23] Hence, the

[21] Article XXIV:8(b), GATT 1994.
[22] See, for instance, Rivas, J. A, "*Do rules of Origin in FTAs Comply with Article XXIV GATT?*", p. 149-150 in Bartels, L. and Ortino, F., "Regional Trade Agreements and the WTO Legal System", Oxford University Press, United Kingdom (2006) [hereinafter Rivas (2006)].
[23] Agreement on Rules of Origin, December 15, 1993 in Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Apr. 15, 1994, The Legal Texts:

composition of such rules is in principle considered to be within the contractual freedom of the parties.

If there is indeed little or no limitation for the parties in this regard, preferential rules of origin can be drafted creatively to prevent not merely the free circulation of imports from outside the free trade area, but the circulation of products that by most ordinary definitions would be considered to stem from a free trade area party, effectively circumventing market liberalization in products or sectors that are sensitive to some or several of the members. At least, there is large room for such adaptation of origin with regards to all products containing input goods originating in a country outside of the free trade area. Generally, the origin of products containing components originating in different countries is dependent on where it was *substantially transformed*. By setting restrictive, complex or exigent requirements for substantial transformation, *i.e.* qualifying for origin within the free trade area, the circulation of unwanted products can effectively be prevented. Substantial transformation could, in theory, require a product to alter not merely heading or item in the tariff classification but chapter. Rules requiring a product to acquire a specific share of its content within the free trade area could be set at close to 100 per cent. Technical requirements could be formulated so that even operations at the bottom end of the production chain which is conducted in an outside country disqualifies the final product from origin within the free trade area.[24]

This risk of circumvention of the duty to liberalize internal trade has led to suggestions of taking into account how the preferential rules of origin are formulated when deciding what ought to be included in the subject for market liberalization. Modifying the subject criteria so that the calculations is based on origin using the rules of origin applied on a *Most Favoured Nation*-basis instead of the preferential rules of origin would provide a more accurate appreciation of what actually originates in the regional trade area.[25] However, an agreement on such an interpretation is unlikely to be reached.

The Results of the Uruguay Round of Multilateral Trade Negotiations 2 (1999), 1867 U.N.T.S. 14, 33 I.L.M. 1143 (1994) [hereinafter Agreement on Rules of Origin].

[24] See, for instance, Estevadeordal, A. et al., "*Multilateralising Preferential Rules of Origin around the World*", Inter-American Development Bank, IDB Working Paper Series No. IDB-WP-137, USA (2009).

[25] Such approaches has indeed been proposed by members, see Committee on Regional Trade Agreements, Note on the Meetings of 6–7 and 10 July 1998 (WT/REG/M/18) (22 July 1998), para. 19.

Thus, for free trade areas, there are not merely difficulties in defining what measures ought to be included in the market liberalization requirement, it is also hard to establish in relation to the trade of what products this duty relates. It seems like there are few limitations on the parties in this regard, rules of origin could be drafted creatively to prevent circulation of sensitive products.

4.1.1.3 Customs unions – trade between member countries or trade in products originating in a member country

As we have mentioned briefly above, and will discuss in length below, customs unions are distinguished from free trade areas by the requirement to form a common external trade policy. It follows logically that according to the main rule custom duties and other restrictive trade regulations should be eliminated on substantially all *the trade between the constituent territories*. If the customs union's members have a common external trade policy, it appears quite rational to let the trade in between them, irrespective of the origin of the goods traded, be the subject to the requirement for internal market liberalization. This means that a product, once let into or produced within the customs union, can circulate freely therein, irrespective of origin.

However, there is also an alternative, less far-reaching, rule for the liberalization of restrictions similar to the *subject rule* for free trade areas. Customs unions can limit the internal trade liberalization to substantially all *the trade in products originating in the constituent parties*. Since this implies the preservation of internal restrictions with regards to products with origin outside the union, it would lead to the formation of a limping customs union, with limited free circulation. It also opens the door to circumvention of the requirement for internal market liberalization by using preferential rules of origin creatively, as explained above. The existence of this alternative *subject rule* for customs unions may appear to be a paradox. After all, why would there be a need for internal restrictions on products from non-parties where there is a common external trade policy treating non-parties uniformly throughout the customs union? The explanation can be found in the exceptions from the requirement to form a common external trade policy, which will be discussed in Section 5. As for now, it suffices to state that the members in a customs union in part can maintain divergent tariff duties and regulations vis-à-vis outside countries and still be considered a customs union. The allowance of such limping customs unions, where external restrictions in part are divergent, is the explanation why the free circulation of products can be limited to products originating in the customs union; it enables the maintaining of divergent external restrictions in the same way as for free trade areas, explained above, although to a lesser extent.

Yet it appears unfortunate that this alternative rule for customs union permits for such a wide exception from internal market liberalization. First of all there is nothing in the rule requiring a correlation between, on the one hand, the external trade policy competence left with the individual customs union member, and, on the other hand, how extensively exceptions from the internal market liberalization can be made based on origin. Irrespectively of how much the member countries pursue individual tariff duties or other restrictions in relation to outside countries they can agree on restrictive rules of origin which limit the extent of the free circulation. Strangely, even a *genuine* customs union, that is to say, a customs union where all external trade policy is common have the option to maintain internal restrictions on products ruled to have origin outside of the customs union.

In sum, customs union parties can decide to eliminate duties and trade restrictions on either trade between the constituent territories or trade in products originating in the constituent parties. The first option follows logically from the requirement to form a common foreign trade policy; where external measures are identical there is no need for limiting the free circulation of products with origin in third countries. The latter option is the result of the exceptions from the flexibilities in the requirement to form a common foreign trade policy. However, strangely there is no requisite for a nexus between the autonomy in external trade policy retained with individual parties and exceptions from free circulation. Thereby, customs union parties are able to limit the free circulation of sensitive products in the same way as in a free trade agreement.

4.2 Degree of internal market liberalization

As we have seen, the rules in Article XXIV:8 provide flexibility in deciding the subject for market liberalization, for free trade areas as well as for customs unions. By enabling the members to limit the internal market liberalization to duties and other restrictive regulations of commerce originating in the customs union or free trade area, the criteria on subject for market liberalization primarily provides flexibility to the internal market liberalization requirement in relation to foreign products, that is to say the trade with non-members of the customs union or free trade area.

However, the flexibility in the internal market liberalization requirement does not halt with the subject rule. Even more elasticity is provided by the requisite deciding to what extent the subject is to be liberalized. To be exact, the flexibility in the requisite for degree of market liberalization is the result of an adverb, *substantially*, qualifying *all the trade* in Article XXIV:8. This requisite is identically formulated for customs unions as for free trade areas. Whereas the subject rule essentially decides what trade is *local* and what trade is *foreign* in the customs union or free trade area as well as deciding what sort of measures are covered by the requirement for internal trade liberalization, the degree criterion, *substantially all the trade*, defines to what extent the local trade needs to be liberalized, once the subject rule has excluded foreign trade from the market liberalization requirement.

In other words, the fundamental difference between these two flexibilities is that whereas the subject requisite *–duties and other restrictive regulations of commerce originating in the customs union or free trade area* – enables the maintaining of trade restrictions in relation to products with origin outside the customs union or free trade area, the degree criterion – *substantially all the trade* – permits the members to exclude certain trade originating in the customs union or free trade area from free circulation. Thereby, *substantially all the trade* enables the maintaining of trade restrictions within the customs union or free trade area. That is to say, to a certain degree; everything but *substantially all* to be exact, internal trade restrictions for products originating in the free trade area can be upheld.

How wide then is this margin of discretion for the customs union or free trade area? How high level of restrictions on the free circulation of goods within the customs union or free trade area can be maintained? For products not originating in the free trade area, the ability to uphold restrictions appears, as we have seen, to be unlimited. Article XXIV:8 simply excludes restrictions in relation to non-members from the obligation to eliminate duties and other restrictive regulations. For products originating within the free trade area on the other hand, the flexibility appears to be much less precisely limited. What level of flexibility the term substantially all the trade actually allows for has been disputed ever since the enactment of the GATT. Nor was the situation made much clearer by the adoption of the Understanding on the Interpretation of Article XXIV [26] during the Uruguay Round of 1994. Failing to agree on an interpretation of the term *substantially all the trade*, the parties merely included general formulations declaring that regional trade agreements that contain profound commitments on internal trade liberalizations increased the contribution to the expansion of world trade.[27]

4.2.1 WTO Case law

Although neither any panel nor the Appellate Body has managed to come up with a definition or interpretation of substantially all the trade, WTO jurisprudence has at least attempted to come up with a specification of the criterion.

In *Turkey Textiles*, the Appellate Body confined itself to reiterate the Panel's statement that "*neither the GATT Contracting Parties nor the WTO Members have ever reached an agreement on the interpretation of the term "substantially" in this provision*."[28] The Appellate Body went further, stating (that) "*it is clear, though, that "substantially all the trade" is not the same as all the trade, and also that "substantially all the trade" is something considerably more than merely some of the trade*."[29]

In an effort to bring light to the matter, the Panel declared that "*the ordinary*

[26] Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994, Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Apr. 15, 1994, The Legal Texts: The Results of the Uruguay Round of Multilateral Trade Negotiations 2 (1999), 1867 U.N.T.S. 14, 33 I.L.M. 1143 (1994) [hereinafter Understanding on the Interpretation of Article XXIV].

[27] "*Such contribution is increased if the elimination between the constituent territories of duties and other restrictive regulations of commerce extends to all trade, and diminished if any major sector of trade is excluded*", 3d recital of the preamble, Understanding on the Interpretation of Article XXIV.

[28] Appellate Body Report, Turkey Textiles, p. 12, Panel Report, Turkey Textiles, Devuyst and Serdarevic (2007), p. 25.

[29] Appellate Body Report, Turkey Textiles, p. 12.

meaning of the term "substantially the same (…) regulations of commerce" in the context of sub-paragraph 8(a) appears to provide for both qualitative and quantitative components; we also consider that in many cases, when constituent members adopt comparable trade regulations having a similar effect, they will be in compliance with the provisions of sub-paragraph 8(a)(ii) whereby constituent members are required to adopt "substantially the same … regulations of commerce". We also consider that the greater the degree of policy divergence, the lower the flexibility as to the areas in which this can occur; and vice-versa."[30]

Apart from *Turkey Textiles*, case law has little to say on the requirement for internal market liberalization. In *US – Line Pipe*, the United States claimed that the elimination "*duties on 97 per cent of the Parties' tariff lines, representing more than 99 per cent of the trade among them in terms of volume*" as evidence for the compliance of NAFTA with Article XXIV:8(b).[31] Without attempting to interpret *substantially all the trade*, the Panel recognized that the United States had established *prima facie* that NAFTA lived up to the requirement for free trade agreements under Article XXIV:8(b).[32] The Appellate Body, however, did not address these two findings and declared that the latter had no legal effect.[33]

Observers have stated that it would be unrealistic and even inappropriate to anticipate panels or the Appellate Body to develop a detailed definition of *substantially all the trade*, since there is a lack of textual basis for any finding of a quantitative threshold. At best, one could expect them to develop a flexible test, taking into account of qualitative and quantitative factors discussed by the Members (see below under Section 4.2.3).[34] However, a close examination shows that case law indeed has opened the door for a detailed interpretation of *substantially all the trade*, built on international law rules on treaty interpretation.

4.2.2 Treaty interpretation

In lack of a consistent interpretation of *substantially all the trade* in case law, it is necessary to resort to treaty interpretation rules. As discussed

[30] Panel Report, Turkey Textiles, p. 100.
[31] Panel Report, "*United States – Defensive Safeguard Measures on Import of Circular Welded Carbon Quality Line Pipe from Korea*" (WT/DS202/R) (29 October 2001) [hereinafter Panel Report, US – Line Pipe], para. 7.142, p. 93.
[32] Ibid, para. 7.144, p. 93.
[33] Appellate Body Report, "*United States – Defensive Safeguard Measures on Import of Circular Welded Carbon Quality Line Pipe from Korea*" (WT/DS202/AB/R) (15 February 2002) [hereinafter Appellate Body Report, US – Line Pipe], paras. 198-199, p. 64-65.
[34] Lockhart and Mitchell (2005), p. 236.

above under Section 4.1.1.1 an analysis based on treaty interpretation rules is sanctioned by case law. According to the general rule of treaty interpretation in Article 31(1) of the Vienna Convention on the Law of Treaties, a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose. According to Article 31(2), *the context* comprises; in addition to the text, including its preamble and annexes, agreements and instruments relating to the treaty which was made in connection with the conclusion of the treaty. Moreover, Article 31(3) explains that together with the context, account should be taken to subsequent agreements between the parties regarding the interpretation of the treaty or the application of its provisions; subsequent practice in application of the treaty which establishes the agreement of the parties regarding its interpretation; and relevant rules of international law applicable in relation between the parties. Article 31(4) states that a special meaning shall be given to a term if it is established that the parties so intended. Supplementary rules on treaty interpretation are found in Article 32, and, for treaties authenticated in two or more languages, in Article 33. What then would these treaty interpretation rules make of the *substantially all*-criterion in GATT Article XXIV?

As explained above, the parties did not manage to clarify the criterion in the Understanding of Article XXIV. Hence, no subsequent agreement provides guidance in accordance with the Article 31(3)(a) of the Vienna Convention on the Law of Treaties.

The Panel in *Turkey Textiles* declared that they would interpret the provisions of Article XXIV in accordance with the Vienna Convention, using first the ordinary meaning of the terms of that provision, as elaborated upon by the 1994 Understanding on Article XXIV, in the context and in light of the object and purpose of the relevant WTO agreements. If need be, to clarify or confirm the meaning of these provisions, the Panel cautioned that the negotiating history, including the historical circumstances that led to the drafting of Article XXIV of GATT may be used as references.[35] However, in the end the Panel did not endeavour to break down the *substantially all*-criterion accordingly.

It has been claimed that the only rule of interpretation which applies to Article XXIV:8 is the implicit reference to the context and circumstances of the treaty's conclusion.[36] In *Turkey Textiles*, the Panel appears to emphasize

[35] Panel Report, Turkey Textiles, para. 9(97), p. 126.
[36] Diouf, E.H.A., "*The ACP Advantage: Interpreting GATT Article XXIV and Market Access Implications for EPAs*", Trade Negotiations Insights, Issue 7, Volume 8,

practice in the application of the treaty, after having established that no consistent interpretation can be inferred from the negotiation history.

"In examining of Article XXIV, we are well aware that regional trade agreements have greatly increased in number and importance since the establishment of GATT 1947 and today cover a significant proportion of world trade. We have also undertaken a detailed analysis of the negotiating history of Article XXIV. We note that the wording of Article XXIV is of sub-optimal clarity and has been the object of various, sometimes opposing, views among individual contracting parties and Members and in the literature. We are also aware that the economic and political realities that prevailed when Article XXIV was drafted, have evolved and that the scope of regional trade agreements is now much broader than it was in 1948."[37]

Such an approach, emphasizing the practice in the application of the treaty, would be in line with Article 31(3)(b) of the Vienna Convention. The Panel, however, does not make such an explicit reference. If indeed the practice of the parties to the GATT were to be decisive in the interpretation of the *substantially all*-criterion one could claim that a thorough analysis and comparison of the degree of internal market liberalization in existing regional trade agreements would provide a definition. Indeed, such comparisons have been undertaken.[38] The results show that the level of internal market liberalization differs widely across examined agreements. Moreover, such an analysis is complicated by several factors: How should "other restrictive regulations" be quantified and weighed against duties under GATT Article XXIV:8?; what sort of measure should form the base for such a definition (average, typical or most frequent levels of market liberalization)?, to name a few. However, even more problematic is that even if one manages to come up with a quantitative figure based on existing regional trade agreements and suggests this as a legal threshold for fulfilling the criterion on substantially all the trade, any such assertion could be challenged by the fact that very few regional trade agreements have been explicitly accepted by the GATT/WTO parties.

Certainly, this position could be countered by playing down the importance of the lack of formal acceptances of the notified regional trade agreements and instead emphasizing that conversely, not even once, has the degree of internal market liberalization in a regional trade agreement been formally

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International Centre for Trade and Sustainable Development and European Centre for Development Policy Management, (September 2009) [hereinafter Diouf (2009)], p. 6.

[37] Panel Report, Turkey Textiles, para. 9.97, p. 126.

[38] See, for instance, Diouf (2009), Scollay, R. and Grynberg, R., *""Substantially All Trade": Which Definitions Are Fulfilled in Practice? An Empirical Investigation, A Report for the Commonwealth Secretariat* (15 August, 2005) [hereinafter Scollay and Grynberg (2005)], Crawford, J. and Laird, S. "*Regional trade agreements and the WTO*", CREDIT Research Paper No. 00/3, CREDIT, University of Nottingham (2000).

challenged by another GATT party. Neither has the Committee on Regional Trade Agreements ever expressly refused to accept a regional trade agreement, nor has the validity of the degree of internal market liberalization in such an agreement ever been disputed legally. Thus, it could be claimed that in lack of contestation of these agreements, GATT/WTO parties have granted their silent consent, *i. e.* that a practice accepting even agreements with very low levels of market liberalization has evolved as the result of the lack of contestations of such agreements.

But it is hard to believe that a definition based on practice in the form of existing regional trade agreements has or would be accepted by WTO parties. Arguably, this would not have been such a big problem if the Vienna Convention's Article 31(3)(b) had lacked its second half: "any subsequent practice in the application of the treaty *which establishes the agreement of the parties regarding its interpretation*." An incoherent practice where no definition or threshold has reached acceptance by even a minority of GATT parties can hardly be regarded as an agreement of the GATT parties. Moreover, there is little reason to believe that the application of the *substantially all*-criterion in the form of regional trade agreements ought to be interpreted as the *opinio juris* of the parties. Indeed, regional trade agreement parties have rarely formulated their positions on internal market liberalization in terms of legal obligations.[39] It is therefore unlikely that the levels of internal market liberalization in existing regional trade agreements can be regarded as practice in the application of the treaty in accordance with Article 31(3)(b) of the Vienna Convention on the Law of Treaties.[40] Thus, practice in the form of existing regional trade agreements can hardly be interpreted as establishing an interpretation of the *substantially all*-criterion.

4.2.3 Proposed solutions

The attempts of agreeing on an interpretation of *substantially all the trade* has made little way since entry into force of the WTO.[41] Not only did the parties fail to agree on a definition in the Understanding on the Interpretation of Article XXIV, also the discussions during the Doha Round have so far failed in this regard.[42]

[39] There are however exceptions. For instance, the EEC/EU has on several occasions expressed their position on how this and other criterias of GATT Article XXIV ought to be interpreted, as discussed below.
[40] Linderfalk, U., "*On the Interpretation of Treaties – The Modern International Law as Expressed in the 1969 Vienna Convention on the Law of Treaties*", Springer, Netherlands (2007), p. 166-167.
[41] Devuyst and Serdarevic (2007), p. 25.
[42] Under Article 31(3)(a) of the Vienna Convention on the Law of Treaties, a subsequent agreement between the parties to the GATT could establish the interpretation of criteria in

In fact, the difficulties in agreeing on a formula for interpreting this criterion have persisted ever since 1957, when the European Economic Community was examined. During this examination, the parties to the Treaty of Rome claimed that "*a free-trade area should be considered as having been achieved for substantially all the trade when the volume of liberalized trade reached 80 per cent (of total trade)*". However, this proposal was rejected by other GATT Working Party Members, claiming it was "*inappropriate to fix a general figure of the percentage of trade*" as a condition for fulfilling the "substantially all" condition.[43] The approach to formulate the requirement for liberalization of *substantially all the trade* as a specific percentage of trade was again opposed during the examination of the Stockholm Convention, establishing the European Free Trade Area (EFTA). In the convention, trade in agricultural products, a major sector in the member countries, had been expressly excluded. The parties claimed the agreement was nevertheless compatible with Article XXIV, declaring that the phrase used in Article XXIV was "substantially all the trade", not trade in substantially all the products. Thereby, they suggested, the exclusion of a certain sector of goods should not preclude conformity with Article XXIV. Although the GATT working parties failed to make a decision on the issue they agreed that no important segment of trade can be omitted from an agreement if that agreement is to meet "substantially all the trade" requirement:

"It was also contended that the phrase "substantially all the trade had a qualitative as well as quantitative aspect and that it should not be taken as allowing the exclusion of a major sector of economic activity. For this reason, the percentage of trade covered, even if it were established to be 90 per cent, was not considered to be the only factor to be taken into account. The member States agreed that the quantitative aspect, in other words the percentage of trade freed, was not the only consideration to be taken into account."[44]

Still to this day, many parties have maintained this position. During the Doha Round, several delegations have opposed attempts to simplify the *substantially all the trade*-criterion into a mathematical formula, expressing that such a definition would fall short of taking into account the qualitative

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the original provisions. However, despite continuous efforts and calls by many ministers the WTO failed to agree on a work plan to address systemic issues related to regional trade agreements on the 8th Ministerial Conference, See Ministerial Conference - Eighth Session - Geneva, 15 - 17 December 2011 - Eighth Ministerial Conference - Chairman's concluding statement (WT/MIN(11)/11) (17 December 2011), p. 5.

[43] Devuyst and Serdarevic (2007), p. 24. GATT, Report Submitted by The Committee on Treaty of Rome to the Contracting Parties on 29 November 1957, Annex IV Q 34, L/778 (29 November, 1957).

[44] Hafez, Zakir, "Weak discipline: GATT Article XXIV and The Emerging WTO Jurisprudence on RTAs", North Dakota Law Review, Vol. 79:4 (2004) [hereinafter Hafez (2004)], p. 890, European Free Trade Association: Examination of Stockholm Convention, GATT B.I.S.D. (9th Supp.) (June 4 1960), para. 70.

aspects.[45] Indeed, throughout the years many different techniques of measuring internal trade liberalization in regional trade agreements have been proposed. Primarily two parallel methods seem to have reached wider acceptance.[46]

4.2.3.1 Qualitative approaches

The first approach emphasizes *qualitative* factors in the internal trade liberalization, requiring the elimination of restrictions in every major sector of the economies of the parties to the regional trade agreement, so that sensitive sectors cannot be altogether excluded from the internal trade liberalization. The advantage with such an approach is that merely parties whom genuinely seek to integrate all of their economies would be eligible for the *regional trade agreement*-exception. However, it presupposes agreement on how to categorize economic sectors. Logically, the more detailed such a division would be, the more demanding the requirement for internal trade liberalization would become. Importantly, the qualitative, or sectorial approach has support in the Understanding on the Interpretation of Article XXIV. In its preamble, the parties recognize, although not in imperative terms, that the contribution to expansion of world trade made by closer integration between the economies of the parties to customs union and free trade areas "*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.*"

4.2.3.2 Quantitative approaches

The second, *quantitative* approach proposes basing a definition of *substantially all the trade* on a statistical benchmark. Most such proposals would require the removal of restrictions with respect to a specific share of the total trade between the regional trade agreement parties.[47] One suggestion, proposed by Australia, is to avoid basing a definition on trade flows, and instead formulate the requirement as share of tariff lines listed in the Harmonized Commodity Description and Coding System[48]. According to this proposal, regional trade agreements would be required to eliminate duties and other restrictions on trade on at least seventy per cent of tariff lines upon entry into force of the regional trade agreement, and ninety-five

[45] Negotiation Group on Rules, Summary report of the Meeting held on 11 June 2003, (TN/RL/M/9) (10 July 2003), para. 20, Devuyst and Serdarevic (2007), p. 26.
[46] Lockhart and Mitchell (2005), pp. 217-252.
[47] Compendium of Issues Related to Regional Trade Agreements (2002), p. 18, Negotiation Group on Rules, Summary report of the Meeting held on 17-18 May 2005 (TN/RL/M/27). (30 June 2005), para. 4, Devuyst and Serdarevic (2007), p. 26.
[48] The Harmonized Commodity Description and Coding System (HS) of tariff nomenclature is an internationally standardized system of names and numbers for classifying traded products developed and maintained by the World Customs Organization (WCO).

per cent within ten years.[49] However, this proposal has two obvious shortcomings. Firstly, it applies only to tariff duties and leaves out other restrictive regulations of commerce, which according to Article XXIV:8 similarly ought to be liberalized. Secondly, concepts based on measuring trade liberalization as share of tariff lines would enable the exclusion of very large or even a majority of actual trade from liberalization in cases where trade is concentrated in a few tariff lines. Clearly this would be a risk for regional trade agreements where one party has a low degree of economic diversification.[50] In order to mitigate this risk, the Australian proposal contained a mechanism prohibiting the exclusion of "highly traded products", defined as products on HS six-digit level which either make up at least 0.2 per cent of the imports from the regional trade agreement partner or are among the fifty largest import products.[51] Nevertheless the proposal was met with opposition, claiming it did not sufficiently take trade volume into account.[52]

Another proposal, which would mitigate the flaws of the tariff line based approach, is to let the *share of trade flows* liberalized under the agreement be decisive. However, this method raises other questions. Firstly, trade flows prior to the formation of the regional trade agreements are curtailed by restrictions that ought to be liberalized in the regional trade agreement.[53] Basing the analysis on those pre-existing trade flows fails to include

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[49] See generally Negotiating Group on Rules, Submission on Regional Trade Agreements by Australia (TN/RL/W/173/Rev1) (3 March 2005) [hereinafter Submission by Australia (March 2005)].
(outlining Australia's proposal), Negotiating Group on Rules, Submission on Regional Trade Agreements by Australia (TN/RL/W/180) (13 May 2005) [hereinafter Submission by Australia (May 2005)] (responding to comments on its previous submission), Devuyst and Serdarevic (2007), p. 26.

[50] This issue has been raised in the WTO. The Korean delegation at a session of the WTO Committee on Regional Trade Agreements (CRTA) argued that the tariff line benchmark might lead to absurd results: "a sizeable proportion of the trade in a particular agreement might lie in less than 5 per cent of the HS tariff lines. The four Faroe Islands agreements met that sort of condition, where well under 50 tariff lines accounted for about 80 per cent of the trade, so here the idea to base coverage on 95 per cent of HS tariff lines might not work", Committee on Regional Trade Agreements, Note on the Meetings of 16–18 and 20 February 1998 (WT/REG/M/16) (18 March 1998), paras. 118, 125, 127, Committee on Regional Trade Agreements, Note on the Meetings of 23–24 September 1998 (WT/REG/M/19) (16 October 1998), para 18.

[51] Submission by Australia (March 2005), Submission by Australia (May 2005), Devuyst and Serdarevic (2007), p. 26-27.

[52] Negotiating Group on Rules, Submission on Regional Trade Agreements - Paper by Japan (TN/RL/W/190) (28 October 2005), Negotiating Group on Rules - Discussion Paper on Regional Trading Arrangements - Communication from India (TN/RL/W/114) (6 June 2003), Devuyst and Serdarevic (2007), p. 27.

[53] Committee on Regional Trade Agreements, Communication from Australia (WT/REG/W/22) (30 January 1998) and Add.1 (24 April 1998) [hereinafter Communication from Australia (April 1998)], See also Committee on Regional Trade Agreements, Note on the Meetings of 16–18 and 20 February 1998 (WT/REG/M/16) (18 March 1998), para. 112.

dynamic effects and potential trade flows that would blossom in lack of restrictions. Naturally, the sectors which are most curtailed by restrictions *a priori* are the most sensitive. These restrictions are often set so high, so only insignificant trade exists. Since the calculation would be based on pre-existing trade flows, the limited amount of trade in sensitive sectors enables the party to maintain restrictions in the same sectors also after the entry into force of the regional trade agreement, without exhausting the flexibility provided by the *substantially all the trade*-criterion. Secondly, it is an open question how the threshold relating to how large share of the trade flows should be liberalized ought to be set. Should the degree criterion be set simply as a share of the total trade flows within the customs union or free trade area or as a share of trade originating from each regional trade agreement party, that is to say as a share of every party's flows of export to another customs union or free trade area party? If the former option is applied, it enables the parties to allocate the duty to liberalize trade restrictions disproportionately between them.[54] If the latter option is utilized, it again highlights the importance of the preferential rules of origin applied under the regional trade agreement. By formulating such rules creatively, sensitive export flows from a regional trade agreement party can be categorized as originating in a third party, thus falling outside the scope of the duty to liberalize internal trade, similar to what was described under Section 4.1.1.2-3

4.2.3.3 Requirement for reciprocity?

It is far from certain whether one regional trade agreement party can bear the lion share of trade liberalizations or if there is indeed a requirement for reciprocity in this regard, and if the latter is the case, how extensive this requirement is.

[54] Communication from Australia (April 1998).

Panels have ruled that where a party to a regional trade agreement attempts to invoke Article XXIV as a ground for using trade preferences selectively, it is possible for another party to dispute this claim and bring it before legal scrutiny in accordance with the dispute settlement procedures under GATT Article XXIII.[55] According to one observer, it can from these cases be distinguished that "*there is now provided a substantive ruling that reciprocity between regional parties is a requirement of GATT Article XXIV:8(b) in order to be qualified as a free trade area. This qualification as it must be contained in the parties' declarations is a pre-condition to securing an Article XXIV exception.*"[56] Accordingly the European Union, the same actor whose trade preference arrangements where challenged in these panels, has adopted their policy and now explicitly declares that a level of reciprocity is required. During the negotiations of the Economic Partnership Agreements, the EU has stated that they consider it necessary for the counterparties to eliminate 80 per cent of restrictions if the EU offers complete and unconditional market access, for the agreements to be WTO-compatible.[57]

[55] See General Agreement on Tariffs and Trade: "*Dispute Settlement Panel Report on the European Economic Community - Import Regime for Bananas*" (Not Adopted), 34 I.L.M. 177 (11 February 1994), General Agreement on Tariffs and Trade: "*Dispute Settlement Panel Report on the European Economic Community - Member States' Import Regimes for Bananas"* (DS32/R) (3 June 1993), Appellate Body Report "*EC – Regime for The Importation, Sale and Distribution of Bananas"* (WT/DS27/AB/R) (9 September 1997), Panel Report, "*European Communities - Regime for the Importation, Sale and Distribution of Bananas - Complaint by Ecuador*" (WT/DS27/R/ECU) (22 May 1997), Panel Report, "*European Communities Regime for the Importation, Sale and Distribution of Bananas - Complaint by Guatemala and Honduras*", (WT/DS27/R/GTM), (WT/DS27/R/HND) (22 May 1997), Panel Report, "*European Communities Regime for the Importation, Sale and Distribution of Bananas - Complaint by Mexico*" (WT/DS27/R/MEX) (22 May 1997), Panel Report, "*European Communities - Regime for the Importation, Sale and Distribution of Bananas - Complaint by the United States*" (WT/DS27/R/USA) (22 May 1997).

[56] Mathis, J.H., "*Regional trade agreements in the GATT/WTO: GATT Article XXIV and the internal trade requirement*" Academisch Proefscrift, Universitet van Amsterdam, Netherlands (2001) [hereinafter Mathis (2001)], p. 63.

[57] The European Commission initially suggested that the 90 per cent threshold should reflect a weighted average taking into account the share of trade of each party in the total bilateral trade; hence, ACP countries with a trade balance surplus should liberalize less than 80 per cent. This reference to trade balance was later in 2007 dropped by the European Commission; see Lui, D. and Bilal, S., "*Contentious issues in the interim EPAs - Potential flexibility in the negotiations*", ECDPM Discussion Paper No. 89, European Centre for Development Policy Management (March 2009), p. 6.

In conclusion it appears likely to assume that a certain level of reciprocity in the internal market liberalization is indeed required. However, even if a requirement for reciprocity indeed can be established this do not settle the question whether the internal market liberalization should be measured qualitatively or quantitatively. One advantage with a qualitative approach is that it safeguards that regional trade agreement parties liberalize sectors where restrictive policies in place before the formation of the regional trade agreement has prevented trade. In a quantitative approach the liberalization of such sectors can more easily be circumvented, since a sector with little trade prior to the agreement will make up a small quantitative share.[58]

Because of the shortcomings of proposed qualitative as well as quantitative methods of setting thresholds for the criterion relating to the degree of market liberalization-criterion, it appears rational to require that they ought to be applied in combination somehow, or at least several quantitative criteria should be used in parallel. Some delegations have proposed basing "*a definition setting minimum percentages for both duty-free tariff lines and trade flows, referring in that context to the need for an adequate approach for evaluating the exclusion of major sectors from the regional trade agreement coverage.*"[59] In the opinion of this thesis, such an approach would be a step in the right direction, essentially bringing GATT Article XXIV closer to GATS Article V, where a sectoral requirement already is in place. It is however clear that an agreement among WTO members on how degree of market liberalization ought to be measured is far away.

[58] Compendium of Issues Related to Regional Trade Agreements (2002), p. 18.
[59] Negotiation Group on Rules, Summary report of the Meeting held on 17-18 May 2005 (TN/RL/M/27) (30 June 2005) para. 4, Devuyst and Serdarevic (2007), p. 26.

5 Trade conditions in relation to third countries

Compared to the requirements relating to internal market liberalization, the requirements for conditions in relation to outside states are more differently formulated for customs unions and free trade areas. Whereas the requirements for internal market liberalization are wholly formulated as conditions for forming a customs union or a free trade area, the requirements relating to trade conditions for outside states are only partly found in the definitions of these instruments.

According to the ordinary meaning of the terms, in a *customs union*, the parties apply essentially the same custom duties and other trade restrictions in relation to third countries. In a *free trade area* on the other hand, the parties retain the ability to have different trade restrictions vis-à-vis non-parties. For free trade area members this is relatively unambiguous; full autonomy over external trade policy is retained. For customs unions on the other hand, the framework appears to require a certain degree, albeit not full, unification of trade conditions in relation to outsiders. GATT Article XXIV:8 (a)(ii) provides that *substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union*. Thereby, the rule calls for the establishment of a common external trade regime. However, it is far from clear what ought to be covered by this common external trade regime and how *common* the policy needs to be.

In addition to *the obligation to harmonize the external trade regime* in a customs union, Article XXIV contains a second rule relating to the trade conditions for third countries, valid for free trade areas as well as customs unions; *the ban on raising barriers in relation to third countries*. Formulated as a prohibition, but outside of the definition of those instruments, it follows from Article XXIV:5(a-b) that the duties and other regulations of commerce maintained in relation to trade with third countries must not on the whole be higher or more restrictive compared to the situation prior to the agreement.

However, before investigating the extent of the obligation to harmonize external trade policies for customs union parties as well as the significance of the prohibition on raising barriers in relation to third countries, we will deal with a definition similar to both rules: The subject for the rules on trade conditions in relation to third countries, or, in other words, what sorts of measures are covered by the GATT rules relating to the treatment of non-members of regional trade agreements.

5.1 Subject of the rules relating to the trade conditions in relation to third countries

According to Article XXIV:8(a)(ii), the requirement for customs unions to set up a common external trade regime relates to *duties and other regulations of commerce*. The exact same wording is repeated in the same article's paragraph 5(a) and (b), relating to the ban on raising barriers in relation to third countries. Moreover, as discussed above under Section 4.1.1.1, the same term is also used in relation to the requirement for internal market liberalization, in paragraph (8)(a)(i) and 8(b), although with the word *restrictive* qualifying *regulations of commerce*.

Although the context varies across the different segments of Article XXIV where the terms are used, some observers have proposed a consistent interpretation.[60] However, a consistent interpretation would imply that the qualifying term *restrictive* in paragraph (8)(a)(i) and 8(b) is ignored. This thesis would find it hard to think that the drafters of GATT did not have a reason for including this term only in those rules. It can hardly be a coincidence that *restrictive* is included in the segments of Article XXIV relating to internal market liberalization whereas it is excluded in the rules relating to the external trade regime of the regional trade agreement. Rather, this thesis claims that the inclusion of *restrictive* modifies the meaning of the terms; qualifying *regulations of commerce* with *restrictive* limits the scope of the former. Logically, such a limitation implies that something falls outside the scope of *restrictive*. As discussed under Section 4.1.1.1, *restrictive regulations of commerce* most likely relates to measures restricting cross-border movement of goods. This would entail border restrictions, and, to some extent, marketplace regulations that adversely affects imported goods in a more burdensome manner than domestic goods. Internal measures may however also qualify, depending on their effect, *i.e.*, primarily whether they are discriminatory or not.

If it is correct that *other regulations of commerce* has a wider scope where it is applied in relation to the external trade regime, those rules could potentially also include measures which are not restrictive, in addition to what is covered by the meaning of *restrictive regulations of commerce*, used in relation to the requirement for internal market liberalization. In the *Turkey Textiles* case, the Panel declared:

"*the ordinary meaning of the terms "other regulations of commerce" could be understood to include any regulation having an impact on trade (such as*

[60] Lockhart and Mitchell (2005), p. 243.

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." [61]

Taken together with the obvious textual differences discussed above, the Panel's definition provides that *other regulations of commerce* is indeed not the same as *other restrictive regulations of commerce*. The opposite conclusion would also yield unreasonable results; if the Panel's definition of *other regulations of commerce* would be valid for *other restrictive regulations of commerce*, then the duty to eliminate such measures would include all regulatory measures having an 'impact on trade'. This would expand the scope of the requirement for *internal market liberalization* into a duty to liberalize virtually all measures hindering complete internal market regimes.[62]

Following the Panel's definition, not merely border measures restricting imports from third countries such as custom duties, import prohibitions, quantitative restrictions and administrative import regulations would be covered as subjects to the Article XXIV rules on trade conditions in relation to outside states; also measures which do not *restrict* commerce but yet somehow affects trade with third countries differently compared to the circulation of domestic goods within the regional trade agreement, would fall within the scope of those rules. Such measures could be marketplace regulations establishing rules that, without distinguishing between goods traded across the border and domestic goods, *in effect* treat goods traded across the border differently. These could, for example, be distribution, transportation, marketing or sales regulations.

Moreover, as previously discussed under the subject of the rules for internal market liberalization, it could be argued that rules of origin could constitute measures which ought to be included as measures subject to the rules in Article XXIV, at least as far as overly restrictive rules of origin are concerned. If the case for an interpretation including rules of origin was weak with regards to internal market liberalization it is considerably stronger in relation to the subject for external trade policy. One observer has claimed that in particular Paragraph 5 of Article XXIV and its chapeau (the prohibition on raising barriers in relation to third countries), read in light of Paragraph 4 prohibits regional trade agreement rules of origin from being more restrictive for imports from third countries.[63]

[61] Panel Report, Turkey Textiles, para. 9.120, p. 131.
[62] Mathis (2006), p. 91.
[63] Rivas (2006).

The issue of what measures ought to be categorized as restricting the external trade of a customs union or free trade area was raised during the Uruguay Round. One proposal was that *duties and other regulations of commerce* should be interpreted to cover "*all border measures taken in connection with importation or exportation which have differential impact on imported products as compared to domestic products*." However, this proposal was rejected, based on "*concerns with respect to the inclusion of a reference to "exportation", to the possible coverage of "border measures""*.[64] This suggests that there is a lack of consensus among negotiators on an interpretation on *other regulations of commerce*. In particular, the Uruguay round discussions illustrate that there is a lack of support for including export measures in the definition of *other regulations of commerce*.[65] However, the round eventually agreed on the Understanding on The Interpretation of Article XXIV of the GATT. The formulations contained in the Understanding are indicative in that it does not make reference to trade generically; when prescribing how *other regulations of commerce* should be evaluated under Article XXIV:5(a), it states that the *assessment shall be based on import statistics*; exports are not even mentioned in the prescription on what ought to be taken into account.[66] Taken together, the apparent rejection of an inclusion of export measures among WTO members and the explicit reference to imports but not exports in the Understanding, can hardly be interpreted in any other manner than as overwhelming support for a limitation of *other regulations of commerce* to measures affecting imports from (but not exports to) third countries.

[64] Committee on Regional Trade Agreements, Systemic Issues Related to 'Other Regulations of Commerce': Background Note by the Secretariat (Revision) (WT/REG/W/17/Rev.1) (5 February 1998), para 10.
[65] Lockhart and Mitchell (2005), p. 244.
[66] See Understanding of Article XXIV under Article XXIV:5.

Returning to *Turkey Textiles* the Panel also stated regarding *other regulations of commerce* that "*Given the dynamic nature of regional trade agreements, we consider that this is an evolving concept.*"[67] This opens the door to a dynamic interpretation of what ought to be interpreted as necessary to include in the external requirements for regional trade agreements. We know for a fact that over the years regional trade agreements have gone from limited *trade in goods*-agreements to today's increasingly common *deep and comprehensive*-free trade agreements. It could be argued, this thesis would claim, based on the Panel's dynamic interpretation, that agreements which includes commitments in trade policy areas which traditionally have not been contained in regional trade agreement would create a corresponding obligation to include the same measures in obligations relating to the external trade policy. For instance, where parties to a regional trade agreement undertake to offer each other preferential access to public procurement, it could create a corresponding obligation to include restrictions for third party actors in tendering for such procurement in the *other regulations of commerce*-requisite. This in turn would require the regional trade agreement parties not to raise barriers for third party actors in relation to such public procurement as well as, for customs unions, include such measures in the common external trade policy. However, such an extensive interpretation would, at best, be highly controversial.

In conclusion, the terms *other regulations of* commerce appears to have a greater coverage than *other restrictive regulations of* commerce. Whereas working parties explicitly have opposed proposed interpretations including measures affecting exports and the Understanding of Article XXIV relates to "*import statistics*" measures affecting exports can probably be excluded. However, in relation to measures affecting imports the scope of the term appears to be quite far-reaching. It clearly includes border measures. Internal measures affecting imports could also be covered, to the extent such measures in effect discriminate imports, as well as overly restrictive rules of origin.

No assertion regarding other measures than border measures could however be made with certainty. Textually, we have found ample support for a wide definition, but broad support among WTO members for such an interpretation appears to be lacking. Moreover, there appears to be some support for a dynamic interpretation of the term. Accordingly, this thesis proposes that the scope of the term should in part depend on the coverage of the agreement, so that regional trade agreements including preferential market access in non-traditional areas would correspondingly include measures in such areas in the coverage of the rules relating to the trade conditions in relation to third countries.

[67] Panel Report, Turkey Textiles, para. 9.120, p. 131.

5.2 Degree of harmonization of the common external trade regime for customs unions

Similar to the *subject* for the common external trade regime of customs unions, it is far from clear to what degree the external trade regime of customs unions must be harmonized, or put conversely; to what degree the customs union parties can maintain individual measures in relation to third countries. As explained above, no such requirement exists for free trade areas. For customs unions, Article XXIV:8(a)(ii) requires that *substantially the same* duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union. The duty to adopt a common external trade regime has also been reaffirmed by the Appellate Body.[68]

The term *substantially the same* indicates that there is a level of flexibility in this regard; but how large is the scope for this part of the external trade policy which can be retained with the individual customs union member? According to one observer, the criterion for degree of harmonization of the external trade regime for customs unions – *substantially the same* - relates *mutatis mutandis* to the criterion for internal market liberalization – *substantially all the trade*, so that an agreement on the latter also would be applicable to the former.[69] However, such a conclusion is far from obvious and the two criteria are therefore dealt with separately in this thesis.

In *Turkey Textiles* the Appellate Body supported a flexible approach of *substantially the same*, noting that it is not required that each constituent member of a customs union applies the same duties and other regulations of commerce as other constituent members with respect to trade with third countries. Moreover, the Appellate Body affirmed that *the phrase "substantially the same"* offer a certain degree of "flexibility" to the constituent members of a customs union in "the creation of a common commercial policy".[70]

[68] Appellate Body Report, Turkey Textiles, para. 49, p. 12.
[69] Lockhart and Mitchell (2005), p. 248.
[70] Appellate Body Report, Turkey Textiles, para. 50, p. 13.

However, the Appellate Body narrowed the same flexibility by declaring that it is limited, underlining that "it must not be forgotten that the word "*substantially*" qualifies the words "*the same*". Therefore, in our view, something closely approximating "sameness" is required by Article XXIV:8(a)(ii)".[71] Moreover, the Appellate Body overruled the finding of the Panel that "comparable" trade regulations having similar effects with respect to the trade with third countries would generally meet the qualitative dimension of the requirement of sub-paragraph 8(a)(ii).[72] Reiterating the requirement in sub-paragraph 8(a)(ii) that the constituent members of a customs union should adopt "substantially the same" trade regulations, the Appellate Body declared that "*"comparable trade regulations having similar effects" do not meet this standard."* The Appellate Body went on to affirm that "*a higher degree of "sameness" is required by the terms of sub-paragraph 8(a)(ii)."*[73] Reaffirming the ruling of the Panel, the Appellate Body declared that it "*encompasses both quantitative and qualitative elements, the quantitative aspect more emphasized in relation to duties*."[74]

However, little guidance can be inferred from practice regarding thresholds for a sufficiently harmonized external trade policy. Formulating such a definition would meet several obvious challenges. Similar to the discussion on degree of internal market liberalization under Section 4.2 it would be necessary to decide to what extent the level of harmonization should be measured qualitatively or quantitatively. In any quantitative approach, *other regulations of commerce* would need to be allocated a value, in order to enable a comparison with tariff duties. Moreover, it would be necessary to distinguish on a relative scale between fully harmonized, partially harmonized and restrictions where the individual customs union party retains autonomy.

Thus, *substantially the same* provides for flexibilities in the common external trade regime for customs unions. However, this flexibility is severely limited. The Appellate Body ruling in *Turkey Textiles* affirms that the framework do not require the rules in relation to third countries to be identical, but more *same* than leading to similar effects for comparable rules, quantitatively as well as qualitatively.

[71] Ibid.
[72] Panel Report, Turkey Textiles, para 9.151, p. 138, Appellate Body Report, Turkey Textiles, para. 50, p. 13.
[73] Appellate Body Report, Turkey Textiles, para. 50, p. 13.
[74] Ibid, paras. 49-50, pp. 12-13, Turkey Textiles, Panel Report, para. 9.148, p. 137.

5.3 Prohibition on raising barriers in relation to third countries

In addition to the requirement for customs unions to establish a common external trade regime found in the definition, Article XXIV:8, GATT Article XXIV imposes additional requirements with regards to trade conditions in relation to outside states.

Article XXIV:4 expresses, although in general rather than imperative terms that the aim with regional trade agreements should not be to hinder the trade of third countries:

"The contracting parties (…) recognize that the purpose of a customs union or of a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories."

In a passage with a seemingly similar purpose in the Understanding on the Interpretation of Article XXIV of the GATT, the parties reaffirm that:

"the purpose of such agreements should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other Members with such territories; and that in their formation or enlargement the parties to them should to the greatest possible extent avoid creating adverse effects on the trade of other Members."[75]

It has been disputed whether Article XXIV:4 form a binding obligation for regional trade agreements. Whereas some members have interpreted the paragraph as a purposive preamble without forming a legal obligation, others have suggested it indeed creates a binding obligation, emphasizing the purpose of the regional trade agreement.[76] The Appellate Body eventually clarified the situation:

*"Paragraph 4 contains purposive, and not operative, language. It does not set forth a separate obligation itself but, rather, sets forth the overriding and pervasive purpose for Article XXIV which is manifested in operative language in the specific obligations that are found elsewhere in Article XXIV. Thus, the purpose set forth in paragraph 4 informs the other relevant paragraphs of Article XXIV (*and that these other paragraphs) *must be*

[75] Understanding on the Interpretation of Article XXIV, fifth paragraph of the Preamble.
[76] Guide to GATT Law and Practice: An analytical Index, Legal Affairs Division, World Trade Organization, (1994), note 105 at 796-98, p. 35. Hafez (2004).

interpreted in the light of the purpose(…) set forth in paragraph 4."[77]

However, even if the references in Article XXIV:4 to adverse effects for third parties do not create a separate obligation, a similar rule with more operative language is found in the subsequent paragraph. Explicitly prohibiting the imposing of higher duties or more restrictive trade conditions, Article XXIV:5 seemingly aim to safeguard that third countries are not put in a worse-off situation:

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

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

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

Whereas the Appellate Body in *Turkey* Textiles made clear that paragraph 4 did not form a separate legal obligation, it came to the opposite conclusion on paragraph 5:

"What paragraph 5(a) provides, in short, is that the effects of the resulting trade measures and policies of the new regional agreement shall not be more trade restrictive, overall, than were the constituent countries' previous trade policies."[78]

[77] Appellate Body Report, Turkey Textiles, para. 57.
[78] Ibid, Turkey Textiles, para. 55. See also Panel Report, Turkey Textiles, paras. 9.120-9.121.

In contrast to the requirement for customs unions to form a common external trade regime in Article XXIV:8 (a)(ii), the ban on putting third countries in a worse-off situation in Article XXIV:5 encompasses not merely customs unions, but also free trade areas, as well as interim agreements for the formation of regional trade agreements, albeit somewhat differently formulated. For a customs union duties and other regulations of commerce should *"not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such union."*[79] Strangely, for free trade areas the requirement lacks the qualifying terms underlined above, and thereby appears to be more absolute. For free trade areas duties and other regulations of commerce should simply "*not be higher or more restrictive*".[80]

Why then, is this requirement differently formulated for free trade areas than for customs unions? And why do free trade areas, generally considered a more "loose" form of cooperation than customs unions, bear a seemingly more absolute ban on raising duties or other restrictions? Most likely, this is explained by the requirement for customs unions to enact common external trade policies. Without a certain degree of flexibility the formation of such a union would be made impossible for countries with different tariff duties. If a customs union were to be founded between countries with converse structure of tariff duties, an absolute requirement identical to the rule for free trade areas would require zero-, or at least very low tariff duties across the line, since the lowest tariff duty any member country had on a tariff position prior to the formation of the customs union would be decisive. In a free trade area, on the other hand, an absolute requirement not to increase duties or other regulations is more reasonable, since autonomy over external tariffs and regulations is retained with the individual member country.

In practice, the fulfilment of the requirement in Article XXIV:5 are relatively easy to control with regard to free trade areas, a simple comparison between the levels prior and subsequent to the formation of the free trade area will suffice.[81] For customs unions, the qualifying terms makes it more complicated. How then, ought an evaluation under Article XXIV:5(a) be undertaken in practice? How should it be measured whether the formation of a customs union has violated the prohibition on raising barriers in relation to third countries?

During the Uruguay Round, the European Community argued that the purpose of examinations under GATT Article XXIV:5 was to evaluate

[79] Article XXIV:5(a), GATT 1994.
[80] Article XXIV:5(b), GATT 1994.
[81] Van den Bossche, P., "*The Law and Policy of the World Trade Organization*", 4th printing, Cambridge University Press, United Kingdom (2010) [hereinafter Van den Bossche (2010)], p. 707.

consequences of the regional trade agreement *"by looking at the total trade of the member States with the other contracting parties taken collectively*."[82] However, the approach to make an overall evaluation was opposed by other Members, suggesting that specific product-by-product effects on individual third parties ought to be taken into account.[83]

Eventually, the parties agreed on a specification in the *Understanding on Article XXIV* which provides guidelines, at least whereas tariff duties are concerned:

"The evaluation under paragraph 5(a) of Article XXIV of the general incidence of the duties and other regulations of commerce applicable before and after the formation of a customs union shall in respect of duties and charges be based upon an overall assessment of weighted average tariff rates and of customs duties collected.(…) For this purpose, the duties and charges to be taken into consideration shall be the applied rates of duty."[84]

For other regulations of commerce, the guidelines are less precise:

"It is recognized that for the purpose of the overall assessment of the incidence of other regulations of commerce for which quantification and aggregation are difficult, the examination of individual measures, regulations, products covered and trade flows affected may be required."[85]

This wording was confirmed by the Appellate Body in *Turkey Textiles*.[86] The assessment under Article XXIV:5 was characterized as an *economic test*, essentially a comparison of trade restrictions before and after the formation of the customs union.[87] However, in the debate concerning Article XXIV:5 many observers have claimed that such an economic test is difficult, if not impossible, to carry out in practice since it requires complex estimations of trade creation and trade diversion effects. Such estimations are becoming increasingly complex as the world economy is becoming more globalized and there is simply no agreement among economists on methodology for measuring the impact of re12gional trade agreements.[88]

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[82] Devuyst, Y., "*GATT Customs Union Provisions and the Uruguay Round: The European Community Experience*", Journal of World Trade 26(1) (February 1992) [hereinafter Devuyst (1992)], Devuyst and Serdarevic (2007), p. 36.
[83] Devuyst (1992), Devuyst and Serdarevic (2007) pp. 28-29.
[84] Understanding on the Interpretation of Article XXIV, para. 2.
[85] Ibid.
[86] Appellate Body Report, Turkey Textiles, para 54, p. 14.
[87] Ibid, para. 55, p. 14. See also Panel Report, Turkey Textiles, paras. 9.120-9.121, p. 131, Van den Bossche (2010), p. 703.
[88] Devuyst and Serdarevic (2007), pp. 38-39.

In contrast to when the same assessment is conducted on a free trade area, adjustments of individual tariff duty positions or restrictions in the formation of a customs union are not critical. In fact, tariff positions can, according to Article XXIV:6, be increased to the extent of actually surpassing duty levels which are bound under GATT Article II. Providing not merely for such an exception but also a compensation procedure if it would occur, Article XXIV:6 thus broaden the scope of what customs unions can deviate from.

It should also be noted that there is an inherent tension between the prohibition on raising barriers in relation to third countries in Article XXIV:5 and the internal market liberalization requirement in Article XXIV:8. *I.e.*, where country a and b form a regional trade agreement and liberalizes restrictions on trade between them whereas country c remains outside, exporters in country b trading with country a will be given an advantage over their competitors in country c. Therefore, the prohibition on raising barriers in relation to third countries should essentially be read in *absolute terms* since the formation of a customs union or free trade area always will raise barriers to third countries in *relative terms*. [89]

Interestingly, the consequence of the prohibition on raising barriers in relation to third countries being placed separately from the definition in Article XXIV:8 is, this thesis would claim, that whereas a free trade area or customs union which fail to fulfil the requirement in the definition, *i.e.* the internal market liberalization-requirement for customs unions and free trade areas or the obligation for customs unions to create a sufficiently common external trade policy, isn't a customs union or free trade area by virtue of the GATT. A free trade areas or customs unions that violates the ban on putting third countries in a worse-off situation but fulfils the other criteria in GATT Article XXIV, on the other hand, would still constitute a legitimate instrument from a judicial standpoint.

In conclusion, the prohibition on raising barriers in relation to third countries constitute an obligation for customs unions as well as for free trade areas to ensure that the result of adjustments of external measures and policies in the formation of such an instrument do not effectively result in more restrictive trade policies. Whereas this criterion is formulated in absolute terms for free trade areas, it can be inferred from practice, despite objections by some members, that the criterion for customs unions is to be measured on an overall-basis. This difference is explained by the requirement for customs unions, as opposed to free trade areas, to form a

[89] Mathis (2006), p. 81.

common external trade policy. Accordingly, an increase of restrictions at the formation of a free trade area suffices for violating of GATT Article XXIV:5. For customs unions, assessing whether the corresponding criterion has been exhausted is more complicated. Some clarification was however provided by the Understanding on the interpretation of GATT Article XXIV, which declare that the general incidence of the applied rates of duties and other regulations of commerce applicable before and after the formation of a customs union based upon an overall assessment of weighted average tariff rates and of customs duties collected shall be indicative in this regard. Essentially, this entails an economic test. However, in reality such a test would be difficult to undertake. Certain restrictions can be increased at the formation of a customs union, provided that compensation is granted. Since the prohibition on raising barriers in relation to third countries is placed outside of the definition of customs unions and free trade areas, a violation of this obligation would arguably not render the customs union or free trade agreement unlawful *per se*.

6 Temporal condition for implementation of interim agreements

Valid for customs unions as well as for free trade areas, Article XXIV:5(c) sets up a temporal condition relating to the implementation period for regional trade agreements:

"any interim agreement referred to in sub-paragraphs (a) and (b) shall include a plan and schedule for the formation of such a customs union or of such a free-trade area within a reasonable length of time."

Again we are confronted with a seemingly imprecise criterion. Interpreting what constitutes a *reasonable length of time* could well be as difficult as the criterion for degree of internal market liberalization. However, in difference to *substantially all the trade* GATT parties have been able to agree on a specification of the temporal condition. In the Understanding of Article XXIV, it is declared that:

"The "reasonable length of time" referred to in paragraph 5(c) of Article XXIV should exceed 10 years only in exceptional cases. In cases where Members parties to an interim agreement believe that 10 years would be insufficient they shall provide a full explanation to the Council for Trade in Goods of the need for a longer period."[90]

The Understanding of Article XXIV thus affirms that in all but *exceptional cases* regional trade agreement undertakings ought to be implemented within 10 years. By virtue of forming a subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions, the rule in the Understanding of Article XXIV must be regarded as establishing the meaning of the *reasonable length of time*-criterion.[91]

[90] Understanding of Article XXIV, para. 3.

[91] Under the General rule of interpretation in the Vienna Convention on the Law of Treaties, Article 3(a) provides that "*any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;*" shall be taken into account. Since the Understanding of Article XXIV was entered into by the same parties who drafted GATT Article XXIV it can hardly be disputed that the former agreement establishes the interpretation of the latter.

What constitutes exceptional cases has not been made clear, but it seems apparent that the term was included with reference to agreement where at least one party has exceptional needs for adjustment periods. Whereas the motivation for entering into regional trade agreements in most cases is long-term economic benefits of facilitating trade, abolishing or decreasing tariff duties does in many cases raise concern for direct losses in state incomes, at least in the short run. Notably in some developing countries, the share tariff duties make up of state revenues can be substantial.[92] It would therefore make sense to reserve the right to derogate from the 10 years-rule for developing countries, or even least developed countries.[93] However, such an application of the temporal criterion would be far from the implementation periods provided by existing regional trade agreements. In many cases, even agreements between developed countries provide for implementation periods exceeding 10 years.[94] However, the trend appears to be that such employment is becoming rarer. When surveying implementation periods in existing regional trade agreements, the WTO Secretariat found that:

"transition periods have become shorter; many RTAs, particularly those which entered into force in the latter half of the 1990s, report transition periods of less than four years, compared with the ten years which was the norm for RTAs signed earlier in that decade. A few recent RTAs have no transition period at all; only in rare cases do transition periods exceed ten years."[95]

An additional concern in evaluating the implementation periods in regional trade agreements could be at what timing most or the substantial part of commitments enter into force. It could be argued that agreements where only a very little share of internal market liberalization commitments are entering into force after 10 years would at least be more acceptable relative to agreements where the lion share of commitments are being realized at the end of a long period. At least from a progressive perspective, ambitious agreements in terms of coverage by internal market liberalization but with long-term implementation are preferable compared to agreements where a large degree of trade is all together exempted. During the examination of its free trade agreement with Chile, the United States argued that the 12 year phase-in periods on certain goods were legitimate, since the degree of internal market liberalization implemented within 10 years was already sufficient for fulfilling the requirements in Article XXIV.[96]

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[92] See, for instance, Kowalski, P., "*Impact of Changes in Tariffs on Developing Countries' Government Revenue*", OECD Trade Policy Working Papers, No. 18, OECD Publishing (2005).
[93] Devuyst and Serdarevic (2007), p. 35.
[94] See, for instance Diouf (2009), Scollay and Grynberg (2005).
[95] *Committee on Regional Trade Agreements - Coverage, Liberalization Process and Transitional Provisions in Regional Trade Agreements - Background Survey by the Secretariat*, (WT/REG/W/46) (5 April 2002)
[96] ACP Secretariat,"*Understanding and Managing the Notification of EPAs at the WTO*", ACP Secretariat (May 2009), p. 25., Committee on Regional Trade Agreements, Free Trade

In conclusion, the meaning of the temporal condition relating to the implementation of regional trade agreement undertakings has been clarified by the specification into a binding 10 year-implementation period as the main rule. However, the application of the exception, that is to say, what constitutes *exceptional cases* is far from clear. This thesis would argue for a case-by-case approach in applying this criterion since the temporal condition hardly can be viewed in isolation. Rather, such examinations must take factual internal market liberalization into account, including both subject and degree of such undertakings. Moreover, the level of economic development in partner countries or difference between the parties in this regard may influence, as well as the timing of implementation of major undertakings.

Agreement between the United States and Chile – Questions and Replies, (WT/REG160/5) (1 August 2005), pp 2-3.

7 Relation between Article XXIV and other GATT/WTO obligations

We have now attempted to interpret the legal criteria for forming a regional trade agreement insofar possible, as well as the central obligations such agreements are bound by, both in relation to one another and third countries. We have found that clear definitions in the form of legal thresholds or criteria on most key elements of the framework of regional trade agreements hardly can be inferred from the framework itself or case law. It is therefore hard to establish the extent of flexibilities inherent to the rules. It remains clear, however, that provided that necessary conditions are fulfilled and flexibilities not exceeded, the framework enables members of such agreements to deviate from the *Most Favoured Nation*-principle. It follows logically from the allowance of such agreements and more specifically from the requirement for internal market liberalization.[97] However, it is less apparent whether Article XXIV provides a legitimate ground for derogation from other GATT provisions as well, or even multilateral undertakings outside of the GATT.

It is evident that areas of contention between regional and multilateral rules will arise. It follows logically from the allowance of regional trade agreements, since such agreements necessarily include undertakings in issue-areas governed by multilateral rules other than the *Most Favoured Nation*-principle. In many cases, such deviations do not result in incompatibility. *Positive deviations* under the requirement for internal market liberalization in GATT Article XXIV:8, *i.e.* where the regional trade agreement undertakings simply go beyond comparable undertakings in multilateral agreements will not give rise to questions of what undertaking is valid. Rather, in such cases the regional rule functions as a *lex specialis* in between its parties; when parties to the regional trade agreement fulfil their undertakings in relation to one another they implicitly comply with the relevant and less-demanding multilateral rule, whereas the latter rule remains the threshold vis-à-vis third countries. *Negative deviations* in regional trade agreements are at least in part prevented by the same rule. That is, negative deviations in the form of undertakings in between the regional trade agreement parties set lower than multilateral agreements are, as discussed under the requirement for internal market liberalization in Section 4.1, unlawful as far as duties and other restrictive regulations of commerce are concerned, with the exception of what falls outside the scope of *substantially all*. In this manner, the framework for regional trade agreements seemingly establishes an ordered relationship between regional and multilateral trade agreements.

[97] See also note 8.

However, there are also examples of derogations which fall outside these two categories; regional trade agreement undertakings in issue-areas not covered by the terms *duties and other restrictive regulations of commerce* which are different compared to multilateral rules. These constitute anomalies in relation to the framework; cases of incompatibility not governed by the framework of regional trade agreements itself. In essence, it highlights the question if derogations from other WTO obligations than the *Most Favoured Nation*-principle can legitimately be based on the framework for regional trade agreements.

In fact, case law has expanded the scope of the *regional trade agreement*-exception. In *Turkey Textiles* Turkey had undertaken measures which they did not dispute were in conflict with the GATT prohibition of quantitative restrictions. However, Turkey asserted that the measures were permitted under GATT Article XXIV, since their imposing was a necessary condition for being able to enter into a customs union with the European Communities. Without permitting the measure in question, the Appellate Body emphasized the importance of the chapeau of paragraph 5, widening the analysis and overruling the Panel's reasoning, which focused primarily on paragraph 5(a) and 8(a). In its chapeau, Article XXIV:5 affirm that the provisions in GATT should not prevent the formation of regional trade agreements.

"…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 of a free-trade area; Provided that:"

Affirming the chapeau of Article XXIV:5 as the decisive passage, the Appellate Body went on to declare that the chapeau should be read in conjunction with its context, considered to be Article XXIV:4.[98] Generally expressing the desirability of agreements increasing the freedom of trade, Article XXIV:4 puts emphasis on the *purpose* of regional trade agreements:

"…the purpose of a customs union or of a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories"

The Appellate Body then declared, based on an interpretation of ordinary meaning, that the terms "*shall not prevent*" in the chapeau of Article XXIV:5 should be read as an affirmation that "*the provisions of the GATT shall not make impossible the formation of a customs union*". Based on this interpretation, the Appellate Body concluded that "*Article XXIV may, under certain conditions, justify the adoption of a measure which is inconsistent with certain other GATT provisions, and may be invoked as a possible*

[98] Appellate Body Report, Turkey Textiles, paras. 43-44, pp. 10-11.

"defence" to a finding of inconsistency."[99]

The ruling reversed the Panel's finding that Article XXIV did not authorize a departure from GATT/WTO obligations other than Article I of the GATT.[100]

This affirmation from the Appellate Body is important, in that it widens the *Regional trade agreement*-exception, making clear that it potentially extends much beyond the principle of *Most Favoured Nation*. However, the Appellate Body cautioned that invoking Article XXIV as a ground for derogating from a GATT obligation requires that all requisites in Article XXIV for forming a customs union must be fulfilled.[101] Moreover, the Appellate Body in *Turkey Textiles* also limited the exception, twofoldly conditioning the invoking of Article XXIV as a legitimate ground for deviating from a GATT obligation:

"Article XXIV may justify a measure which is inconsistent with certain other GATT provisions. However, in a case involving the formation of a customs union, this "defence" is available only when two conditions are fulfilled. First, the party claiming the benefit of this defence must demonstrate that the measure at issue is introduced upon the formation of a customs union that fully meets the requirements of sub-paragraphs 8(a) and 5(a) of Article XXIV. And, second, that party must demonstrate that the formation of that customs union would be prevented if it were not allowed to introduce the measure at issue. Again, both these conditions must be met to have the benefit of the defence under Article XXIV."[102]

7.1 Temporal condition

Firstly, building on the wording *the formation of a customs union* in the chapeau of Article XXIV:5 the Appellate Body affirmed that Article XXIV can justify a departure from a GATT obligation *only if the measure is introduced upon the formation of the customs union*. Perhaps this temporal limitation is most important read conversely; once the customs union is established, no further derogations from the GATT can be made. This has far-reaching consequences for regional trade agreements, in that it establishes the timing for their formation as a benchmark for questions of legality regarding measures in their common external trade policy. Read conversely, the Appellate Body ruling affirms that unless a derogation from the GATT was invoked at the time of formation it is unlawful. *I. e.* such policies can be made more liberal with regard to outsiders, but never more restrictive. From the point of view of members to an economic integration project this rule may appear impractical, not least since at the time of

[99] Ibid, para 46, p. 11.
[100] Panel Report, Turkey Textiles, paras. 9.186-9.188, p. 147.
[101] Appelate Body Report, Turkey Textiles, paras. 47-51.
[102] Ibid, para. 58, p. 16.

formation of a customs union, the future development of an economic integration project must often be hard to decide, making it hard if not impossible to overview or foresee what exceptions needs to be invoked. If upheld in relation to the EU, the consequence of the rule would be that the legality of all potentially GATT-inconsistent measures in the common external commercial policy not in place at the time of the 1957 Treaty of Rome would be ruled as unlawful.

7.2 Necessity condition

Secondly, from the same terms in the chapeau of Article XXIV:5; *the formation of a customs union*, the Appellate Body affirmed that it is not sufficient that the measure which is incompatible with a GATT obligation is introduced at time of the formation of the customs union. The scope of the derogation is also decisive; an otherwise GATT incompatible measure can be justified by Article XXIV "*only to the extent that the formation of the customs union would be prevented if the introduction of the measure were not allowed.*"[103] Thereby, the ruling establishes a second benchmark for deciding the legality of GATT derogations based on Article XXIV, doubtlessly more complicated than the temporal test. Deciding whether a certain measure is necessary for the creation of a customs union must be regarded as a difficult task. Since the design of a common external trade policy for a customs union is a highly political process it could be questioned what sort of "impossibilities" are sufficient for fulfilling the necessity-benchmark. Would lack of political will from party A to modify a specific measure in its external trade policy suffice for party B to enact the same measure when jointly forming a customs union? In principle, all GATT derogations are the results of a lack of will to adapt to the agreed framework, not of reasons beyond a members control.

In *Turkey – Textiles*, Turkey argued that since 40 per cent of its total export to the European Communities (EC) was made up of textile and clothing products and the EC maintained measures limiting such imports from India, the EC would exclude these products from free trade within the Turkey-EC customs union if Turkey did not introduce restrictions on such imports from India. If such measure was not applied, Turkey asserted, the customs union would fail to liberalize substantially all the trade, in accordance with Article XXIV:8(a)(i).[104] The Appellate Body accepted this reasoning insofar as to affirm that the risk of trade diversion to the EC of textile and clothing products originating in India would prevent the customs union from being formed. However, as explained below they suggested other, GATT-compatible measure to restrict such imports.[105] What is most interesting with the Appellate Body's reasoning however is that it does not for once suggest – or even examines – why the EC would not be able to adopt a more

[103] Ibid, para. 46, p. 11.
[104] Ibid, para. 61, p. 17.
[105] Ibid, para. 62, p. 17.

liberal policy in relation to Indian textiles imports, similar to the Turkish policy prior to the formation of the customs union. Strangely, it is as if the Appellate Body regards the EC's restrictive policy as a law of nature, which Turkey must adhere to. One can question why the Appellate Body has not endeavoured a more flexible approach. In the opinion of this thesis, it would be more reasonable to make an initial investigation of the restriction in question and enquire whether it would not be more appropriate for the new customs union to adopt the more liberal of the two parties' previous policies, as the common position in its external trade policy. Such an approach would also be more in the spirit of the GATT's general declaration of the role of regional trade agreements, found in Article XXIV:4.

"The contracting parties recognize the desirability of increasing freedom of trade by the development, through voluntary agreements, of closer integration between the economies of the countries parties to such agreements. They also recognize that the purpose of a customs union or of a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories."[106]

The fact that the Appellate Body so critiquelessly accepts the reasoning that it is the more liberal policy which should adapt to the more restrictive, when forming a customs union, this thesis would argue, is counter to the spirit of Article XXIV:4. It is especially paradoxical since the Appellate Body in other passages of its ruling points at this very passage as instrumental.[107]

7.3 Burden of proof

Another important question relates to the burden of proof. Is it the member of the regional trade agreement derogating from the GATT who needs to show that the measure in question is necessary? Or, does the non-parties as the result of the regional trade agreement, face a second bar for showing that a violation is at hand? That is to say, not merely showing that a GATT violation is at hand but also showing that the violation was in fact not legitimate under Article XXIV?

[106] Article XXIV (4), GATT 1994.
[107] See above and Appellate Body Report, Turkey Textiles, paras. 43-44, pp. 10-11.

As previously stated, panels have ruled that where a party to a regional trade agreement attempts to invoke Article XXIV as a ground for using trade preferences selectively, it is possible for another party to dispute this claim and bring it before legal scrutiny in accordance with the dispute settlement procedures under GATT Article XXIII.[108] According to one observer, it can from these cases be distinguished that between the special procedures for review of regional trade agreements in GATT XXIV:7, and the general consultation procedures provided by GATT Article XXIII, there is a basis for requiring a *prima facie* review of such agreements, to determine if it fulfils the requirements in Article XXIV and thus can serve as a basis for exceptions from the *Most Favoured Nation*-principle and other GATT provisions. Thereby, the panels place the burden on the respondent party who has chosen to invoke Article XXIV to show that the regional trade agreement is legitimate. Thus, although regional trade agreements may be "self declaratory" in nature, they are not necessarily self-qualified by declaration.[109]

Strangely, when formulating the rule on how panels should examine such matters, the Appellate Body in *Turkey Textiles* did not specify *what party* should show that necessary conditions have been met for derogating from GATT obligation based on the *regional trade agreement*-exception.

"We would expect a panel, when examining such a measure, to require a party to establish that both of these conditions have been fulfilled. It may not always be possible to determine whether the second of the two conditions has been fulfilled without initially determining whether the first condition has been fulfilled. In other words, it may not always be possible to determine whether not applying a measure would prevent the formation of a customs union without first determining whether there is a customs union."[110]

However, when discussing the *regional trade agreement*-exception, the Appellate Body in *Turkey Textiles* repeatedly refers to it as a *defence*. It thus appears to be the party derogating from a GATT commitment that needs to

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[108] See General Agreement on Tariffs and Trade, Panel Report "*European Economic Community - Import Regime for Bananas*" (Not Adopted), 34 I.L.M. 177 (11 February 1994), General Agreement on Tariffs and Trade, Panel Report "*European Economic Community - Member States' Import Regimes for Bananas*" (DS32/R) (3 June 1993), Appellate Body Report "*European Communities – Regime for The Importation, Sale and Distribution of Bananas*" (WT/DS27/AB/R) (9 September 1997), Panel Report, "*European Communities - Regime for the Importation, Sale and Distribution of Bananas - Complaint by Ecuador*" (WT/DS27/R/ECU) (22 May 1997), Panel Report, "*European Communities Regime for the Importation, Sale and Distribution of Bananas - Complaint by Guatemala and Honduras*", (WT/DS27/R/GTM), (WT/DS27/R/HND) (22 May 1997), Panel Report, "*European Communities Regime for the Importation, Sale and Distribution of Bananas - Complaint by Mexico*" (WT/DS27/R/MEX) (22 May 1997), Panel Report, "*European Communities - Regime for the Importation, Sale and Distribution of Bananas - Complaint by the United States*" (WT/DS27/R/USA) (22 May 1997).

[109] Mathis (2001), p. 63.

[110] Appellate Body Report, Turkey Textiles, para. 59, p. 16.

establish that the derogation is legitimate:

"*…Article XXIV can, in our view, only be invoked as a defence to a finding that a measure is inconsistent with certain GATT provisions…*"[111]

In a later passage, the Appellate Body explains:

"*…this "defence" is available only when two conditions are fulfilled. First, the party claiming the benefit of this defence must demonstrate that the measure at issue is introduced upon the formation of a customs union that fully meets the requirements of sub-paragraphs 8(a) and 5(a) of Article XXIV. And, second, that party must demonstrate that the formation of that customs union would be prevented if it were not allowed to introduce the measure at issue. Again, both these conditions must be met to have the benefit of the defence under Article XXIV.*"[112]

The fact that the Appellate Body refers to the *regional trade agreement*-exception as a defence is important. Based on WTO law practice, one can thereby draw the conclusion that it is in fact the party claiming that a derogation from the GATT is legitimate based on Article XXIV who needs to establish that necessary conditions are fulfilled. Generally, the burden of proof in WTO dispute settlement proceedings is on the party, the complainant or the respondent, that asserts the affirmative of a particular claim of defence.[113] This was established by the Appellate Body in *US – Wool Shorts and Blouses*:

"we find it difficult, indeed, to see how any system of judicial settlement could work if it incorporated the proposition that the mere assertion of a claim might amount to proof. It is, thus, hardly surprising that various international tribunals, including the International Court of Justice, have generally and consistently accepted and applied the rule that the party who asserts a fact, whether the claimant or the respondent, is responsible for providing proof thereof. Also, it is a generally accepted canon of evidence in civil law, common law and, in fact, most jurisdictions, that the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defence. If that party adduces evidence sufficient to raise a presumption that what is claimed is true, the burden then shifts to the other party, who will fail unless it adduces sufficient evidence to rebut the presumption.[114]

However, in *Japan – Apples*, the Appellate Body made clear that essentially distinctive principles relating to burden of proof apply to, on the one hand assertions of breach of a specific commitment, and, on the other hand, assertions of facts:

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[111] Ibid, para. 52, p. 14.
[112] Ibid, para. 58, p. 16.
[113] Van den Bossche (2010), p. 207.
[114] Appellate Body Report, "*US – Measures Affecting Imports of Woven Wool Shirts and Blouses from India*" (WT/DS33/AB/R) (23 May 1997).

"it is important to distinguish, on the one hand, the principle that the complainant must establish a prima facie case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof. In fact, the two principles are distinct".[115]

In cases of establishing whether a GATT derogation based on the regional trade agreement is legitimate, it would thus be for the complaining party to show that a *prima facie* GATT inconsistency is at hand. Since the regional trade agreement according to case law is a *defence*, and, moreover, since that defence rests upon an *assertion of fact* that a specific measure is necessary in order to form a regional trade agreement, it would then be for the respondent, that is to say the party violating a GATT obligation based on a claim of *regional trade agreement*-exception, to establish that the exception is in fact legitimate.

Unfortunately procedural issues relating to burden of proof were not highlighted in *Turkey Textiles* since nor the derogation from the GATT (a violation of the ban on quantitative restrictions), nor the assertion of facts were disputed by Turkey (respondent). Nevertheless, the Appellate Body appears to have followed the model illustrated above, requiring Turkey as respondent to establish that the *regional trade agreement*-exception was applicable.[116] In the end the Appellate Body ruled that Turkey failed to pass the necessity test, by declaring that the measure violating the ban on quantitative restrictions was not necessary for forming the customs union. Rather, the Appellate Body appear to have meant, the *impossibility* could be circumvented by other, GATT-compatible measures, such as differentiated rules of origin. This, the Appellate Body affirmed indirectly, would be within the margins of the flexibilities inherent in the definition of customs unions in Article XXIV, that is to say, the margin of discretion offered outside "*substantially all*" in Article XXIV:8(a).[117]

Despite the issue not being resolved in *Turkey Textiles* there appears to be sufficient support in case law for establishing that it is the regional trade agreement party derogating from a GATT/WTO obligation that is required to show that necessary conditions for are fulfilled, *i.e.* that the temporal condition as well as the necessity condition.

In conclusion, the relationship between regional trade agreements and multilateral trade rules in the WTO is complex. Undertakings in regional trade agreements may form both positive and negative derogations from corresponding multilateral undertakings. Positive undertakings, *i.e.* undertakings that go beyond multilateral agreements, such as tariff

[115] Appellate Body Report, "*US Japan – Measures Affecting The Importation of Apples*" (WT/DS245/AB/R) (26 November 2003).
[116] Appellate Body Reports, Turkey Textiles, para. 61, p. 17.
[117] Ibid, Turkey Textiles, paras. 62-63, pp. 17-18.

eliminations, are in essence the purpose of Article XXIV. They create legitimate exceptions from the *Most Favoured Nation*-principle. Negative derogations relating to duties and other restrictive regulations of commerce are in most cases prevented by the requirements in Article XXIV. However, there may also be derogations in regional trade agreements that fall outside the scope of these two categories. From case law it can be established that regional trade agreement can legitimately deviate from other multilateral undertakings than the *Most Favoured Nation*-principle provided that the measure is introduced at the formation of the regional trade agreement and that the creation of the regional trade agreement would be prevented if the introduction of the measure was not allowed. The bar for the latter criterion appears to be set remarkably low considering the general spirit of Article XXIV. The burden of proving that necessary conditions for derogating from WTO obligations in a regional trade agreement are fulfilled lies with the regional trade agreement party, once the complaining party has established a *prima facie* GATT/WTO-inconsistency.

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