

**International Commerce & Policy Program  
School of Public Policy  
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**How the Multilateral Trade System Under the World Trade  
Organization is Attempting to Reconcile the Contradictions &  
Hurdles Posed by Regional Trade Agreements**

An Analysis of Article XXIV  
of the General Agreement on Tariffs & Trade

Donald A. Calvert  
Master's Capstone Thesis  
**December 6, 2002**

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This thesis is dedicated to Norma Lang Steuerle, whose life tragically ended in the terrorist attacks on America of September 11, 2001. Words can't express how much I miss Norma and how precious she was to me. If there is a Heaven, Norma is there.

*"The heights by great men reached and kept,  
Were not attained by sudden flight,  
But they, while their companions slept,  
were toiling upward in the night."*

Henry Wadsworth Longfellow, 1858

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**Abstract**

This thesis examines the deficiencies in the legal-institutional framework that governs the controversial relationship between the world's 255 regional trade agreements (RTAs) and the global, multilateral trade system. Last fall, trade ministers from the World Trade Organization's (WTO) 144 member-countries signified the importance of this issue by agreeing to clarify WTO rules governing RTAs in the new Doha Development Round of trade talks to reform the world trade system. This thesis first illustrates the concerns that have placed RTA rules at the top of the Doha agenda. As a prelude to the legal analysis, it then briefly reviews the larger debate over whether RTAs contribute to or weaken and damage the multilateral system. Next, it explores the deficiencies in the WTO's legal framework for managing RTAs, focusing exclusively on the shortcomings of Article XXIV of the General Agreement on Tariffs and Trade. In this section, the thesis (1) highlights the most controversial, ineffectual provisions of Article XXIV, (2) discusses the inutile process by which countries notify RTAs to the WTO, and (3) demonstrates that the WTO's review in assessing RTAs' compliance (or lack thereof) with Article XXIV is perfunctory and useless. The thesis then examines what is being done to address this problem, reviewing proposals in the WTO aimed at modifying Article XXIV. Ultimately, this thesis argues that changes to effectuate a more concrete, viable management of RTAs in the multilateral system are unlikely to occur in the foreseeable future.

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**I. Introduction¾ Why Regional Trade Agreements are Such an Important Issue in the  
World Trade Organization**

In November 2000, then-Director General of the World Trade Organization (WTO) Mike Moore speculated that the world trade system’s future might be in question due to the escalating popularity of regional trade agreements:

*Is there a risk that regionalism is becoming a stumbling-block, more than a building block, for the new WTO, draining energy from multilateral negotiations, fragmenting international trade, and creating a new international dis-order characterized by growing rivalries and marginalization and the possibility of hostile blocks?<sup>1</sup>*

Moore wasn’t questioning the importance or value of regional trade agreements. He was, however, articulating a growing concern shared by many trade policymakers and economists that the proliferation of regional trade agreements spurred by globalization may be endangering the future of the world trade system that has been in place since the end of World War II. Moore’s predecessor Renato Ruggiero had, in fact, voiced a similar concern in 1996, when he wrote, *“Ensuring that regionalism and multilateralism grow together¾and not apart¾is perhaps the most urgent issue facing trade policy-makers today.”<sup>2</sup>* And, just last month, Moore’s successor, the new WTO Director-General Supachai Panitchpakdi, warned that *“by discriminating against*

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<sup>1</sup>*“Globalizing Regionalism: A New Role for Mercosur in the Multilateral Trading System,”* Speech by Mike Moore, Director General, World Trade Organization, Buenos Aires, November 28, 2000.

<sup>2</sup>*Multilateralism and Regionalism in Trade,”* by Renato Ruggiero, Director-General, World Trade Organization, U.S. Information Agency, Economic Perspectives, WTO View, November 1996, p.1.

*third countries and creating a complex network of trade regimes, such agreements pose a systemic risk to the global trading system.”*<sup>3</sup>

Regionalism refers to the pursuit of trade agreements between countries or groups of countries across the globe. Bilateral and regional accords offer incentives and advantages to trade among members to the disadvantage and exclusion of non-members.<sup>4</sup> These "regional trade agreements", or RTAs<sup>5</sup>, as they will be referred to in this thesis, have been growing at an enormous pace over the last 30 years. As of December 2002, 255 RTAs have been notified to the WTO, with scores of additional RTAs under negotiation around the world.<sup>6</sup> Regional trade comprises more than half of world trade and RTAs are in place on every continent. In fact, virtually all of the WTO's 144 members are parties to RTAs.<sup>7</sup>

The other half of world trade is conducted through the global, international trade system via multilateralism. Although it has no single definition, "multilateralism" in this context refers to trade conducted without discrimination throughout the world trade system.<sup>8</sup> In 1948, the world's economic powers created this system by negotiating an international law—the General Agreement on Tariffs and Trade (GATT)—which established the system's rules. A half-century

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<sup>3</sup> *“Overview of Developments in the International Trading Environment,” Annual Report of the Director-General, Trade Policy Review Body, World Trade Organization, WT/TPR/OV/8, Nov. 15, 2002, p. 3.*

<sup>4</sup> *“Regionalism and the Multilateral Trading System,” Doha WTO Ministerial 2001, Briefing Notes, World Trade Organization, p. 1.*

<sup>5</sup> In this thesis, unless otherwise noted for purposes of analysis, “RTAs” will refer collectively to regional trade agreements, free trade agreements, customs unions, and free trade areas. Note that this thesis contains no discussions of the concept of “open regionalism,” which is considered by some to be an alternative form of a RTA because it allows nonmembers to join at any time. Open regionalism is not discussed here because it does not constitute a viable alternative to RTAs in the eyes of most trade policymakers and economists. To understand why it doesn't work as a valid policy alternative on sheer economic grounds, see *“Is the WTO's Article XXIV a Free Trade Barrier?”*, Working Paper No. 49/00, Centre for the Study of Globalisation and Regionalisation, by Ben Zissimos and David Vines, pp. 31-32.

<sup>6</sup> *“Draft Report (2002) of the Committee on Regional Trade Agreements to the General Council,”* World Trade Organization, Committee on Regional Trade Agreements, WT/REG/W/47, Nov. 4, 2002, p. 1.

<sup>7</sup> *“Regionalism and the Multilateral Trading System,”* WTO Briefing Notes, p. 1.; *World Trade Organization Annual Report 2002*, p. 40.; *“Overview of Developments in the International Trading Environment,”*; *Annual Report of the Director-General*, p. 1.

<sup>8</sup> *“Trading into the Future,”* World Trade Organization, 2nd edition, Revised March 2001, p.4.

later, the GATT law became a formal institution in Geneva—the World Trade Organization (WTO)—whose purpose is to foster free trade flow among all WTO members and adjudicate trade disputes under a Dispute Settlement Body.<sup>9</sup> At the heart of the GATT-WTO system is the rule that WTO members may not discriminate against other members. In other words, if a WTO member lowers a duty for another member, it must do so for all members.<sup>10</sup> This principle of non-discrimination is one of the main reasons countries join the WTO. It provides for a “level-playing field” for all members to trade goods and services with one another.

And yet, it’s easy even for non-economists to see why there is a natural tension between RTAs and the WTO system. RTAs—by definition—provide trade benefits to other members at the exclusion and discrimination of non-members that should be protected from such discrimination under WTO rules.<sup>11</sup> Despite this, the GATT’s founding fathers recognized that RTAs could benefit and invigorate the multilateral trade system. At the same time, they feared that, left unchecked, RTAs could damage and even weaken the world system. Their solution was to create a special provision—GATT Article XXIV—that allows for RTAs only when two conditions are met: (1) the level of a RTA’s trade barriers toward non-members are not “on the whole” higher than prior to the RTA’s formation, and (2) a RTA liberalizes “substantially all the trade” between its members.<sup>12</sup> Article XXIV was, in essence, an attempt to allow RTAs to exist within the larger system without damaging that system by having to follow certain disciplines.<sup>13</sup> The hope was that Article XXIV would permit RTAs as an interim exception to the WTO’s non-discrimination rule until they could eventually transition into full, multilateral nondiscriminatory

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<sup>9</sup> Ibid.

<sup>10</sup> Ibid, p. 5.

<sup>11</sup> WTO 2002 Annual Report, p. 40.

<sup>12</sup> GATT Article XXIV, Paragraphs 5 and 8.

<sup>13</sup> "*Regionalism and WTO Rules: Problems in the Fine Art of Discriminating Fairly*," by Robert E. Hudec and James D. Southwick, Chapter 2 of *Trade Rules in the Making: Challenges in Regional and*

liberalizing measures.<sup>14</sup> So, GATT's framers intended Article XXIV to be the system's instrument for both managing RTAs and encouraging their transformation into multilateral, GATT trade agreements.

Of course, what the GATT's creators could not foresee was the degree to which RTAs would become popular in the decades to follow. Nor did they envision that such RTAs would fail to transform into multilateral accords and that their presence as self-contained, non-expanding trade regimes could actually weaken and endanger the larger system, as Supachai, Moore, and many others fear. Certainly GATT framers thought that Article XXIV would protect the multilateral system from such an outcome. However, as the new millennium began, concerns about regionalism's impact on the multilateral system was of such concern to trade policymakers that it was placed at the top of the agenda at last November's launch of the Doha Development Round of trade talks. In Doha, trade ministers from countries in all corners of the WTO system agreed to reexamine RTA rules via *"negotiations aimed at clarifying and improving disciplines and procedures under the existing WTO provisions applying to regional trade agreements."*<sup>15</sup>

This thesis demonstrates why GATT Article XXIV has proven to be ineffective in governing RTAs and what is being done in the ongoing negotiations to address the issue. It first examines Article XXIV's shortcomings as a law and how it is subject to potential abuse and noncompliance by parties. It also documents how Article XXIV's notification requirements are rarely followed by RTA members. Finally, it demonstrates why the WTO's process of reviewing whether RTAs comply with Article XXIV's criteria has proven to be meaningless. Following the legal analysis, this thesis examines what is being done within and outside of the WTO to

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*Multilateral Negotiations*", M. Mendoza, P. Low, and B. Kotschwar, Editors, Brookings Institution Press, 1999, p. 48.

<sup>14</sup> "GATT and the European Community: A Formula for Peaceful Coexistence," *Michigan Journal of International Law*, Fall, 1990, by Frederick M. Abbott, p. 3.

<sup>15</sup> Doha WTO Ministerial 2001: Ministerial Declaration, Paragraph 29, WT/MIN(01)/DEC/1, Adopted on November 14, 2001.

address this problem. Ultimately, the thesis analyzes the prospects for reforms to Article XXIV and demonstrates why such reforms are unlikely to occur in the foreseeable future.

A brief synopsis of the debate over whether RTAs help or hurt the multilateral system is a logical place to start in analyzing the deficiencies of the Article XXIV framework.

## **II. The Debate Surrounding RTAs<sup>3</sup>/<sub>4</sub> Trade Creation v. Trade Diversion**

Before examining the systemic faultlines in Article XXIV, it is important to understand the arguments that both support—and challenge—the contributions of RTAs to the multilateral system. International economists typically frame this debate around whether RTAs are “trade creating” or “trade diverting.”<sup>16</sup> This conceptual distinction was developed in 1950 by the eminent economist Jacob Viner. Viner saw RTAs to be trade creating when a RTA allows its members to replace the importation of expensive, inefficiently produced goods from a non-member with cheaper, more efficiently-produced goods from other RTA members. A trade creating RTA, Viner postulated, makes economically sensible trade more possible between member countries.<sup>17</sup>

On the other hand, Viner saw RTAs to be trade diverting when they foster inefficient commerce wherein a member, because of the RTA's rules, engages in unhealthy trade practices. Trade diversion occurs when a RTA member imports costly, less-efficiently produced goods from another RTA member rather than importing those same goods from a more efficient non-member only because the RTA artificially lowers the cost.<sup>18</sup> In other words, Viner postulated, RTAs are counterproductive and trade diversionary if they foster trade within a RTA that simply doesn't make sense economically. He argued that trade diversion reduces economic welfare

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<sup>16</sup> “*Free Trade Agreements: Impact on U.S. Trade and Implications for U.S. Trade Policy*,” CRS Report for Congress, Congressional Research Service, The Library of Congress, by William H. Cooper, April 9, 2002, p.7.

<sup>17</sup> *Ibid.*

<sup>18</sup> *Id.*



when the “club rules” of a RTA prevent healthy economic trade conducted through natural market preferences.<sup>19</sup>

Forceful arguments can be made on both sides in the modern debate about RTAs. Proponents suggest that RTAs are stepping stones for countries in the journey toward full liberalization. RTAs, they argue, help “lock in” new liberalization, may be more efficient than multilateral agreements to begin liberalizing in specific sectors, may fuel domestic political momentum for subsequent liberalization, and may foster liberalization in other regions.<sup>20</sup> Former Treasury Secretary Lawrence H. Summers favors RTAs because, he argues: (1) their trade creating effects are likely to exceed the trade diverting effects; (2) even trade diverting RTAs will likely improve some economic welfare; (3) RTAs are likely to have both trade and non-trade benefits; and, (4) well-constructed RTAs will accelerate larger, multilateral liberalization rather than slowing it down.<sup>21</sup> For Summers, trade liberalization means trade liberalization, irrespective of whether it is achieved regionally or multilaterally.<sup>22</sup>

Edward L. Hudgins of the Cato Institute agrees with Summers, arguing that RTAs—even if they result in some trade diversion—offer better prospects for addressing complex, intractable trade issues than does the slow, often cumbersome, WTO system.<sup>23</sup> Jeffrey J. Schott of the Institute for International Economics (IIE), argues that countries like the U.S. can't afford to *not* be party to such agreements. For Schott, nonparticipation represents lost opportunities and lost business because U.S. exporters are handicapped when competing against producers in countries

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<sup>19</sup> *Id.*

<sup>20</sup> “*Trade Blocs: Barriers or Stepping Stones for Global Trade?*,” Jeffrey A. Frankel, Harvard Univ., Keynote Speech before International Federation of Associations of Business Economists, The African Finance Journal, November 19, 1997, Vancouver, Canada, p.11.

<sup>21</sup> “*Regionalism and the World Trading System*”, Lawrence H. Summers, Chapter 27, Trading Blocs: Alternative Approaches to Analyzing Preferential Trade Agreements, Edited by J. Bhagwati, P. Krishna, and A. Panagariya, The MIT Press, Cambridge, Mass., p. 562

<sup>22</sup> *Ibid.*

<sup>23</sup> “*Regional and Multilateral Trade Agreements: Complementary Means to Open Markets*,” The CATO Journal, Vol. 15, No. 2-3, by Edward L. Hudgins, Fall/Winter 1995-96, p.7.

that are parties to RTAs.<sup>24</sup> Finally, one of the most outspoken proponents of RTAs is IIE Director C. Fred Bergsten, who argues that RTAs are “the next best thing” to multilateral agreements and ultimately promote global liberalization.<sup>25</sup>

Opponents to RTAs take a much different stance, arguing that RTAs pose a threat to multilateral trade rules. Even Bergsten—one of the most ardent supporters of RTAs—has argued that, left unchecked, regionalism could result in a three-bloc (U.S., Europe & Asia) trade world and a potential Transatlantic trade war. The only way to avoid these outcomes, Bergsten argues, is “*for the WTO to be reinforced, reestablished, and reinvigorated at the center of the trading system.*”<sup>26</sup>

The eminent economist Jagdish Bhagwati of Columbia University shares Bergsten’s concerns about the impact of RTAs on the multilateral system. As one of the most outspoken critics of RTAs and ardent supporters of the WTO, Bhagwati regards RTAs as inferior to multilateral agreements because, by definition, they deny trading opportunities to non-members. Bhagwati also asserts that a RTA is inherently unhealthy even for the member countries themselves because it forces them to engage in wasteful, discriminatory trade practices rather than trading induced by healthy market preferences.<sup>27</sup> Bhagwati also argues that RTAs fail to “lock in” positive reforms in member countries and instead solidify protectionist measures toward non-member countries that may have existed prior to a RTA.<sup>28</sup> Finally, Bhagwati argues, RTAs pose administrative nightmares because of clashing, incongruent regulations that exist not

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<sup>24</sup> CRS report, p. 12.

<sup>25</sup> Ibid.

<sup>26</sup> “*New Multilateral Round Vital to Counter Drift Toward three-Bloc World*,” Speech by C. Fred Bergsten, Director, Institute for International Economics, 2001 Annual Meeting of the Trilateral Commission, London [specific date of speech was unattainable].

<sup>27</sup> “*Multilateralism and Regionalism in the Post-Uruguay Round Era: What Role for the US?*”, Jagdish N. Bhagwati, Chapter 2 of Multilateralism and Regionalism in the Post-Uruguay Round Era: What Role for the EU, Edited by O. Memedovic, A. Kuyvenhoven and W. Molle, Kluwer Academic Publishers, Boston, 1999, p. 34.

<sup>28</sup> Ibid, p. 35.

only between two RTAs, but between RTAs and multilateral rules. For Bhagwati, this “spaghetti-bowl phenomenon” of RTAs such as NAFTA (the North American Free Trade Agreement), MERCOSUR (the Southern Common Market), EFTA (the European Free Trade Association), and ASEAN (the Association of Southeast Asian Nations) poses a danger to the larger world trade system because true, multilateral free trade gets lost in the vacuum of conflicting rules of the world’s 255 RTAs.<sup>29</sup>

### **III. Why GATT Article XXIV Is Insufficient in Managing Regional Trade Agreements**

As stated earlier, GATT Article XXIV was intended to be the instrument that would allow RTAs to exist in—and complement *without harming*—the global trade system. Paragraph 4 of Article XXIV<sup>30</sup> establishes that RTAs can exist within the multilateral system: “*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.*”<sup>31</sup> However, Paragraph 4 also provides a caveat that RTAs cannot harm the larger system: “*The purpose of a customs union or 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.*”<sup>32</sup>

The importance of Article XXIV:4 is that it establishes the role of regionalism within the auspices of the multilateral system. Paragraphs 5 and 8 provide specific criteria RTAs must meet to be WTO-GATT compliant. This section first explores why Paragraphs 5 and 8 are ambiguous and subject to potential noncompliance and even abuse by countries that are parties to RTAs and don’t want to be constrained by Article XXIV. It next examines the weaknesses in Article XXIV’s rules governing when countries must notify RTAs to the WTO. Finally, it looks at the

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<sup>29</sup> Ibid, p.36.

<sup>30</sup> For brevity, references to paragraphs in Article XXIV will be denoted as such: XXIV:4.

<sup>31</sup> GATT Article XXIV:4.

process by which the WTO reviews RTAs to determine their compliance with Article XXIV and shows how this review is meaningless in ensuring that RTAs complement and not harm the WTO system.

**A. An Obsolete Law¾ How Article XXIV Has Been Ignored & Abused by Parties**

The two main requirements a RTA must meet before it is allowed to operate legally within the GATT-WTO system are (1) trade barriers cannot on the whole increase after a RTA is created and (2) RTAs must cover substantially all trade among their members.<sup>33</sup>

**1. Paragraph 5¾ Trade Barriers Must on the Whole Not Increase from a RTA**

Article XXIV, Paragraph 5, stipulates that RTA members must not increase the overall level of trade barriers toward non-members after the agreement is concluded:

the general incidence of duties and other restrictive regulations of commerce shall not on the whole 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 [RTA].<sup>34</sup>

XXIV:5 is in essence an external harness designed to limit a RTA's trade barriers toward nonmembers. Two issues have emerged in the legal history of XXIV:5. First, how does the WTO judge whether a RTA meets this requirement? Second, is there evidence to suggest that RTA countries may use XXIV:5 to justify introducing—rather than eliminating—otherwise *illegal* trade barriers?

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<sup>32</sup> GATT Article XXIV:4.

<sup>33</sup> This section does not attempt to address all legal issues raised by Article XXIV, nor does it address the plethora of legal issues surrounding other GATT requirements on RTAs, including the GATS and the Enabling Clause. This section only addresses the problematic Article XXIV requirements most often cited in the legal and academic literature. For a comprehensive listing of all RTA legal issues, see: (1) “*Compendium of Issues Related to Regional Trade Agreements*,” Negotiating Group on Rules, World Trade Organization, August 1, 2002, TN/RL/W/8/Rev.1 (02-4246) and (2) “*Synopsis of ‘Systemic’ Issues Relating to Regional Trade Agreements, Note by the Secretariat*”, March 2000, Restricted, 00-79, WT/REG/W/37, March 2, 2000, No. 00-0789. These sources are used and cited later in this thesis.

<sup>34</sup> GATT Article XXIV:5(a) & (b). Note 5(a) addresses customs unions while 5(b) addresses free trade areas. References to XXIV:5 in this thesis will refer collectively to XXIV:5(a) & (b).

The first issue raised by XXIV:5 is how the WTO judges whether a RTA's barriers are "not on the whole higher or more restrictive" than levels prior to the agreement's formation. Article XXIV:5 is completely silent in defining pivotal terms in the statute. This has made it difficult, if not impossible, for RTA parties and the WTO itself to determine if this requirement has been met.<sup>35</sup> For example, what does "duties and other restrictive regulations of commerce (ORRCs)" mean? Precisely how are ORRCs calculated for purposes of meeting this requirement? Does "ORRCs" mean individual tariff lines, specific trade measures, or a country's tariff schedule as a whole? Does it refer to "bound" or "applied" tariff rates, the first being maximum, "ceiling" rates a RTA member agrees to apply to non-members, or, the second being the actual rates applied, which may be lower?<sup>36</sup> The answer to this unresolved issue could mean the difference between a country meeting this requirement, or not. However, Article XXIV:5 provides no guidance on this.

Other questions surrounding XXIV:5 have emerged. Does the "general incidence of duties" and ORRCs have to involve an examination of a specific product's pre- and post-RTA duties, or, can an increase of duties in one sector (e.g. textiles) be offset by an associated greater decrease of duties in another sector (equipment)?<sup>37</sup> Should ORRCs include trade policy measures such as rules of origin, variable levies, quantitative restrictions, and customs users

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<sup>35</sup> "WTO Rules Relating to Regional Trade Agreements," by Edwini Kessie, Counsellor, Council & Trade Negotiations Committee, World Trade Organization, PowerPoint Presentation for Trade Policy Issues Workshop, Asian Development Bank, Singapore, Malaysia, February 25, 2002, p. 13.

<sup>36</sup> "Agriculture, GATT, and Regional Trade Agreements" by Sharon Sheffield, U.S. Department of Agriculture Agricultural Economic Report, "Regional Trade and U.S. Agriculture," Market and Trade Economics Division, Economic Research Service, November 1998, AER/771, p. 88.; "Regionalism and WTO Rules: Problems in the Fine Art of Discriminating Fairly," p. 53.

<sup>37</sup> "Regionalism and WTO Rules: Problems in the Fine Art of Discriminating Fairly," p. 53; "Does Regional Integration Foster Open Trade? Economic Theory and GATT's Article XXIV", John McMillan, Graduate School of International Relations and Pacific Studies, Univ. of California, San Diego, from "Regional Integration and the Global Trading System", K. Anderson and R. Blackhurst, eds., London, Harvester Wheatsheaf, 1993, p. 1.

fees?<sup>38</sup> In sum, exactly how does the WTO compare pre- and post-RTA trade barriers to judge a RTA's compatibility with GATT Article XXIV:5? And, how does a WTO member that is party to a RTA know if it has satisfied this requirement?

GATT-WTO officials and member-countries have never agreed on how XXIV:5's evaluation should be made.<sup>39</sup> The European Union (EU) has argued that a "balancing" approach should be allowed. According to the EU, a RTA's increase of discriminatory trade barriers in one sector (e.g. agriculture) may be more than offset by liberalization of another sector (e.g. manufacturing) as long as it leaves the non-RTA members "on the whole" better off after the RTA in accordance with the statute.<sup>40</sup> Countries outside the EU, however, have vociferously argued that an increase in trade barriers in violation of XXIV:5 is just that—a violation—and cannot be offset or compensated by balancing a trade barrier's increase in one sector with alleged reductions to other sectoral barriers.<sup>41</sup>

Sungjoon Cho of Harvard University Law School argues that the GATT-WTO's legal jurisprudence has consistently rejected this balancing idea.<sup>42</sup> If the WTO allowed this, Cho contends, then the EU and other WTO members would be permitted to get away with substantial trade diversion, since they could expand trade barriers in a sensitive sector such as agriculture where other members—especially developing countries—are likely to have a comparative advantage.<sup>43</sup> Such a statutory loophole would not only allow the EU to maintain its outdated, costly, and trade-diversionary Common Agricultural Policy, it would do so at the expense of

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<sup>38</sup> Kessie, p. 15.

<sup>39</sup> Ibid, p. 24.

<sup>40</sup> "Breaking the Barrier Between Regionalism and Multilateralism: A New Perspective on Trade Regionalism," Harvard International Law Journal, Summer 2001, by Sungjoon Cho, President and Fellows of Harvard College., 42 *Harv. Int'l L.J.* 419, 441.

<sup>41</sup> Ibid.

<sup>42</sup> Id.

<sup>43</sup> Id.

smaller countries whose agricultural sectors represent their most promising—and perhaps only—“foot in the door” into the world trade system.

The balancing issue raised in Article XXIV:5 has led to another, related question on whether countries can introduce quantitative restrictions under a RTA as long as some test can be shown to satisfy Article XXIV:5. In 1999, “*Turkey–Restrictions on Imports of Textile and Clothing Products*” (hereinafter *Turkey–Textiles*) became the first dispute settlement case in GATT-WTO history that addressed issues raised by Article XXIV.<sup>44</sup> At issue in the case were quantitative restrictions (QRs) Turkey had placed on imports of textile and clothing from India to uphold its obligations in forming a RTA with the EU. Turkey argued that XXIV:5 does not prevent the imposition of a QR as long as the “general incidence” test above can somehow be satisfied.<sup>45</sup> India challenged this view, arguing that RTA parties cannot simply introduce trade barriers already prohibited by GATT: “*the terms of Article XXIV:5 do not provide a legal basis for measures otherwise incompatible with GATT/WTO rules,*” India argued.<sup>46</sup>

The WTO Panel in *Turkey-Textiles* agreed with India, ruling that countries cannot use Article XXIV to introduce QRs already prohibited under GATT Article XI (General Elimination of Quantitative Restrictions) and Article XIII (Non-Discriminatory Administration of Quantitative Restrictions).<sup>47</sup> The panel also argued that QRs could be considered ORRCs that are *expressly limited* by XXIV:5.<sup>48</sup> However, the WTO Appellate Body subsequently issued a report reversing the Panel decision on this issue, concluding 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 'defence' to a finding of inconsistency*” with

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<sup>44</sup> Cho, p. 445; World Trade Organization Panel Report on *Turkey-Textiles*, adopted on May 31, 1999 (WT/DS34/R).

<sup>45</sup> Cho, p. 445; Kessie, p. 17.

<sup>46</sup> Kessie, p. 18.

<sup>47</sup> Cho, p. 446.

Article XXIV:5.<sup>49</sup> The Appellate Body placed two conditions on a country's use of this exception. To form a RTA that is exempt from Article XXIV:5, the Appellate Body contended, a country must (1) demonstrate that the QRs in question are introduced upon the RTA's formation and (2) that the formation of the RTA would have been prevented if the country were not allowed to introduce the QRs.<sup>50</sup>

The Appellate Body's reversal of the Panel decision and the criteria it created to justify QRs are rather odd given the nature of RTAs themselves. RTAs—by definition—require member countries to reduce trade barriers to members, or to increase barriers to non-members, when the RTA takes effect. This establishes the exclusionary “club rules” that make insiders better off (and outsiders worse off) and is essential to making the RTA work.<sup>51</sup> Given this, it seems that a RTA member could very easily—by virtue of the RTA itself—legally justify the introduction of an otherwise illegal QR under the Appellate Body's test. Why would the WTO's Appellate Body sanction QRs when they seem to undermine the basic limits Article XXIV:5 attempts to place on countries introducing such measures?

Although WTO dispute settlement decisions are not binding in the way that American court decisions are, the *Turkey-Textiles* Appellate Body ruling seems to have opened the door for countries' subsequent introduction of otherwise illegal QRs under XXIV:5. In a 2001 dispute settlement case, *United States – Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities* (hereinafter *US-Wheat Gluten*), the Panel cited in its report the *Turkey Textiles* Appellate Body ruling, concluding that “Article XXIV of the GATT 1994 may provide a defence to a claim of violation of a provision of the GATT 1994, and may also provide

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<sup>48</sup> Ibid.

<sup>49</sup> *Turkey-Textiles* Appellate Body Decision, adopted on October 22, 1999 (WT/DS34/R), par. 45, p.11.

<sup>50</sup> WT/DS34/AB/R, para. 58.

<sup>51</sup> “*Is the WTO's Article XXIV a Free Trade Barrier?*”, Working Paper No. 49/00, Centre for the Study of Globalisation and Regionalisation, by Ben Zissimos and David Vines, p. 1.



*a defence to a claim of inconsistency with a provision of another covered agreement if it is somehow incorporated into that provision or agreement.*"<sup>52</sup> Here, the *US-Wheat Gluten* panel seemed to be reiterating that countries may not only use Article XXIV:5 to justify illegal QRs under GATT 1994 provisions, but under other GATT provisions as well.

If Article XXIV:5 was an attempt to restrict a RTA's introduction of trade-diverting barriers, the opposite outcome has seemed to have occurred. It has become a vehicle for legally justifying—rather than preventing—such barriers. Given this, along with the fact that it is littered with unresolved issues around what it truly requires, it is not surprising that XXIV:5, according to Edwini Kessie, a counsellor in the WTO's Council & Trade Negotiations Committee in Geneva, is "*one of the most controversial provisions in the GATT.*"<sup>53</sup>

## **2. Paragraph 8<sup>3/4</sup> RTAs Must Cover "Substantially All Trade" Among Members**

Article XXIV, Paragraph 8, requires the elimination of trade barriers with respect to "substantially all the trade" (SAT) between RTA countries.<sup>54</sup> Unlike Paragraph 5, which serves to limit trade discrimination to countries outside of a RTA, Paragraph 8 seeks to protect RTA members themselves from another member's exclusion of trade from the agreement. The idea behind the SAT requirement was to ensure that countries go "all the way" in their regional liberalization.<sup>55</sup> As stated earlier, GATT framers wanted RTAs to be vehicles that would eventually lead to multilateral free trade agreements and not remain "stuck" as self-contained, discriminating regional initiatives. The SAT requirement, it was thought, would prevent this.

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<sup>52</sup> Panel Report on *US –Wheat Gluten*, adopted on 19 January 2001 (WT/DS166/R), para. 8.180; August 2002 Compendium, Paragraph 37.

<sup>53</sup> "*WTO Rules Relating to Regional Trade Agreements*," by Edwini Kessie, Counsellor, Council & Trade Negotiations Committee, World Trade Organization, Powerpoint Presentation for Trade Policy Issues Workshop, Asian Development Bank, Singapore, Malaysia, February 25, 2002, p.12..

<sup>54</sup> GATT Article XXIV, Paragraph 8.

<sup>55</sup> Kessie, p. 43.

The problem with XXIV:8 is that there has never been any agreement on just how much liberalization must occur before a RTA member satisfies the SAT test. Such an agreed understanding, according to Australia, “has so far eluded the [GATT/WTO] membership.”<sup>56</sup> This confusion, according to the WTO’s Committee on Regional Trade Agreements (CRTA), has resulted in an impasse in the WTO’s review of RTAs’ compliance with Article XXIV.<sup>57</sup> In other words, Article XXIV’s imprecise, unclear, and highly controversial requirements have prevented the WTO itself from enforcing Article XXIV.

CRTA has indicated that two interpretations of the SAT requirement have emerged. One is a quantitative approach, which favors defining SAT as a statistical benchmark, such as a certain percentage of the trade between the RTA members, to indicate whether a RTA’s trade coverage fulfills the SAT rule.<sup>58</sup> The problem with this quantitative approach, asserts CRTA, is that countries use it to exclude a predetermined, set amount of trade, including such sensitive sectors as agriculture, textiles, and clothing.<sup>59</sup> It has been argued, for example, that the European Free Trade Association, by excluding agriculture, violates XXIV:8.<sup>60</sup> The other approach, a qualitative one, means that RTAs cannot exclude any sectors (or at least major ones) from the intra-RTA trade liberalization. However, CRTA points out that this approach, even if it includes all sectors, does not automatically guarantee free trade.<sup>61</sup> According to Kessie, CRTA has not formally adopted or endorsed either approach.<sup>62</sup>

Both Australia and the EU have taken a great interest in how the WTO should interpret XXIV:8’s SAT requirement and both differ sharply on the issue. Australia for instance has argued that “substantially all the trade” requires RTA parties to include all sectors (*especially*

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<sup>56</sup> Kessie, p. 44.

<sup>57</sup> *WTO’s 2000 Synopsis of ‘Systemic’ Issues Relating to Regional Trade Agreements*, Par. 54.

<sup>58</sup> *Ibid.*

<sup>59</sup> *Id.*

<sup>60</sup> Kessie, p. 47.

<sup>61</sup> *Ibid.*

*agriculture*). The EU has, in turn, argued that the word “substantially” in the SAT requirement does not obligate a country to liberalize all of its trade; otherwise “substantially” would be meaningless and would not have been included in the statute.<sup>63</sup> The Panel in the *Turkey-Textiles* case examined this issue and concluded that the “ordinary meaning of the term ‘substantially’...appears to provide for both qualitative and quantitative components.”<sup>64</sup> Unlike the QR issue in XXIV:5, the Appellate Body on this point agreed with the Panel, concluding that XXIV:8’s SAT test requires *both* a percentage of trade to be liberalized and the non-exclusion of any major sector. The Appellate Body argued that this test offers the requisite flexibility because, although “substantial” is clearly not the same as “all”, it does require “something considerably more than merely *some* of the trade.”<sup>65</sup>

Despite the Appellate Body’s optimism about its clarification of XXIV:8 in *Turkey Textiles*, one could argue that, by requiring both qualitative and quantitative approaches, it only exacerbated the confusion and debate surrounding the SAT requirement. According to Hudec and Southwick (1999), the confusion about this requirement remains as high today as it did before the Uruguay Round.<sup>66</sup> They speculate that the GATT drafters knew the SAT requirement would cause a legal quagmire, but that requiring barriers to be reduced on *all* intra-RTA trade would have been impossible for prospective RTA countries to achieve and might have discouraged too many RTAs.<sup>67</sup>

Bhagwati argues that XXIV:8’s SAT requirement was intended to close all potential legal loopholes that would allow the GATT/WTO system to degenerate into an array of less-than-100-

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<sup>62</sup> Ibid, p. 46.

<sup>63</sup> Ibid, p. 48.

<sup>64</sup> Ibid, p. 52.

<sup>65</sup> Id.

<sup>66</sup> “*Regionalism and WTO rules: The Art of Discriminating Fairly*,” p. 61.

<sup>67</sup> Ibid, pp. 61-62.

percent RTAs.<sup>68</sup> In practice, he argues, this rule's ambiguity and political pressures from RTA advocates has made it nearly impossible for the GATT/WTO to sanction RTAs that cover all trade between its members.<sup>69</sup>

In retrospect, Article XXIV, Paragraphs 5 and 8, were well-intentioned provisions that were shaped by competing interests and pressures. On the one hand, they were created to limit abuses by RTAs. On the other hand, they were left sufficiently vague so as not to discourage the formation of RTAs. The problem with these statutes is that they have not served as a concrete legal anchor to govern RTAs in the multilateral system. Precisely what these rules require remains a fundamentally unanswered question even a half-century after the system's creation. The result, as we have seen, is that Article XXIV may actually promote the use of trade barriers rather than limiting them. But this is only one reason why policymakers are considering amending Article XXIV. Two other flawed processes—the notification of RTAs to the WTO and the WTO's ensuing review of them—are explored next.

#### **B. Basic Notification Procedures Are Not Followed by Members**

For a moment, let's assume that Article XXIV's requirements for RTAs under Paragraphs 5 and 8 were concise, well-defined rules. For even for the best-written law to work, it needs to be enforced. And, in order for Article XXIV to be enforced, the WTO needs a mechanism by which it is timely notified that RTAs exist or are under consideration so that it can assess their compliance. Article XXIV, Paragraph 7(a), contains such a provision, which states that "*any [Member] deciding to enter into a...RTA...shall promptly notify*" the WTO and make

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<sup>68</sup> "Regionalism and Multilateralism: An Overview", by Jagdish Bhagwati, Chapter 1 from Trading Blocs: Alternative Approaches to Analyzing Preferential Trade Agreements, Edited by J. Bhagwati, P. Krishna, and A. Panagariya, The MIT Press, Cambridge, Mass., 1999, p. 7.

<sup>69</sup> Ibid.

available to it all information the WTO needs to make an assessment of the RTA's compliance with Article XXIV.<sup>70</sup>

The problem with this notification requirement is that it is unclear as to when a country must notify the WTO of a RTA. Most RTAs, in practice, are already in force long before the WTO is notified of their existence.<sup>71</sup> In the RTA between the EU and Turkey discussed previously, the WTO was notified of the RTA a full two months after it went into effect. In responding to criticism on this, the EU argued that *"it might be impracticable for parties to a RTA to notify their agreement before its implementation."*<sup>72</sup>

Paragraph 7's only guidance on this timing requirement is the phrase "shall promptly notify," which could mean notifying the WTO before a RTA is concluded or months, and even years, after one is concluded. Not surprisingly, WTO members have differed sharply on this timing issue, depending upon whether they favor multilateral WTO liberalization, or if instead they have stakes in promoting RTAs.<sup>73</sup> While some parties have argued that this notification should take place before the RTA enters into force, others have insisted that RTAs deserve a case-by-case approach in the notification timing to account for complexities and political/legal difficulties that may be at issue in a RTA's ratification.<sup>74</sup> In practice, many RTAs are simply never notified to the WTO, especially in developing countries.

The inadequate and untimely notification of RTAs has been the subject of much concern in this year's meetings of the WTO's Committee on Regional Trade Agreements (CRTA). In CRTA's third and final meeting of the year in Geneva two weeks ago, the CRTA's Chairman, Boniface Guwa Chidyausiku of Zimbabwe, voiced his concern about the gap between the

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<sup>70</sup> GATT Article XXIV:7(a).

<sup>71</sup> WTO August 2002 Compendium, par. 1.1.1, p. 5.

<sup>72</sup> Kessie, p. 40.

<sup>73</sup> WTO August 2002 Compendium, par. 1.1.1, p. 5.

<sup>74</sup> Ibid.

number of RTAs that exist and those that have actually been notified to the WTO.<sup>75</sup> Chidyausiku urged WTO members to comply with their notification obligations under Article XXIV:7 and explained the consequences of members' recurrent delays in providing CRTA with the documentation it needs to examine individual RTAs. These include difficulties in the CRTA planning the duration of its meetings, the costs incurred by the WTO on unused resources (e.g. interpretation services), and the "appearance of a considerable time-lag for the first round of examination of an increasing number of RTAs."<sup>76</sup> What could Chidyausiku do to stimulate more effective compliance? His only tool was to cordially invite WTO members to make sure that they provide the WTO with the requisite documents in accordance with deadlines established prior to CRTA's three annual meetings.<sup>77</sup>

What is the likelihood that Chidyausiku's kind words will stimulate WTO countries—who are expending limited resources in negotiating RTAs—to take the time and expense to provide the WTO with documents that the WTO wants, but whose required submission is anything but clear in Article XXIV:7? Highly unlikely, especially given the fact that there are no consequences for countries failing to abide by Article XXIV, which brings us to the final deficiency in rules governing RTAs—the WTO's review and enforcement of Article XXIV, which is essentially meaningless.

### **C. WTO's Review Process of RTAs is Meaningless**

The final deficiency in the WTO's legal framework for governing RTAs concerns the rules by which it evaluates RTAs' compliance with Article XXIV criteria. To examine this shortcoming in isolation of the two already described, let's, for a moment, assume that (1) Paragraphs 5 and 8 are well-defined, (2) the notification procedures are straightforward, and (3)

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<sup>75</sup> "Report (2002) of the Committee on Regional Trade Agreements to the General Council," World Trade Organization, WT/REG/11, No. 02-6517, November 25, 2002, p. 2.

<sup>76</sup> Ibid.

the WTO receives all of the information it needs to evaluate a RTA's compliance with these rules. To make GATT Article XXIV work as intended even under these best of theoretical circumstances, the WTO must have a strong, decisive adjudicatory body that determines a RTA's compliance or lack thereof with Article XXIV and an associated process by which illegal RTAs are required to conform to the rules.

The WTO has a surveillance process for evaluating RTAs. Prior to 1996, RTAs were notified to the Council for Trade in Goods (CTG) after which the CTG established a "Working Party" to review the agreement.<sup>78</sup> The Working Party then issued a report presenting its conclusions and recommendations to the CTG on whether the RTA should be sanctioned as GATT-compliant. The problem was that these reports were often inconclusive and the Council rarely required RTA parties to make changes to their RTAs.<sup>79</sup>

In 1996, an attempt was made to improve this examination process. That year, the WTO created the CRTA, discussed earlier, to conduct the WTO's rules of RTAs. CRTA was set up to (1) assess the GATT-compatibility of individual RTAs and (2) evaluate the deeper, systemic implications of RTAs on the multilateral system.<sup>80</sup> It also was designed to be a standing body to replace the ad hoc examinations of RTAs by numerous Working Parties with systematic, decisive evaluations of RTAs.<sup>81</sup>

Has the CRTA successfully met its mandate that was set out in 1996? There is evidence to suggest that the CRTA has fulfilled the second mission. Since 1996, CRTA has issued some valuable reports on this issue and raised public awareness about the problems surrounding multilateralism and regionalism. These reports have highlighted the decades of legal debate

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<sup>77</sup> Id.

<sup>78</sup> Kessie presentation, "*The Procedural Aspects-The Examination Process*", p. 1.

<sup>79</sup> Ibid; McMillan, p. 10.

<sup>80</sup> "*Work of the Committee on Regional Trade Agreements*," World Trade Organization Background Document on WTO website, [www.wto.org](http://www.wto.org) (undated).

<sup>81</sup> Kessie Presentation, "*The Procedural Aspects-The Examination Process*," p. 5.

within the GATT-WTO about the deficiencies in rules governing RTAs, especially Article XXIV.<sup>82</sup> To its credit, CRTA has served as the primary WTO body that examines RTAs and RTA issues. Working with limited resources, CRTA has done probably all it can do in attempting to gather information about RTAs and issuing these broader reports on this problem.

That notwithstanding, there is little evidence to suggest that CRTA has adequately performed its review of RTAs or issued conclusive reports determining their compliance with the GATT. Since its creation in 1996, the CRTA has not found a single RTA to violate GATT Article XXIV.<sup>83</sup> Conversely, CRTA has never formally sanctioned a RTA as being compliant with WTO rules.<sup>84</sup> The CRTA also has had enormous difficulty in completing its factual examinations of RTAs, a process that precedes their legal analysis. Often, years ensue before the GATT-WTO is able to complete this preliminary factual examination. In the case of the Southern Cone Market agreement, or MERCOSUR, it was notified to the GATT in 1993, but a decision on the CRTA's factual review of MERCOSUR has yet to be reached, nine years later.<sup>85</sup> Just last week, CRTA issued its 2002 Report to the General Council where it reported that it had pursued its examination work and the factual review of several RTAs. However, the final sentence of the report concluded that CRTA "has been unable to finalize reports on any of the examinations before it."<sup>86</sup>

The WTO has not hesitated to vocalize its discontent with CRTA's work. Last month's 2002 Annual Report by the WTO Director-General, for example, concluded that the CRTA has

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<sup>82</sup>See reports referenced in Footnote 33. Also see the CRTA's website at [www.wto.org/english/tratop\\_e/region\\_e/regcom\\_e.htm](http://www.wto.org/english/tratop_e/region_e/regcom_e.htm) for more information about the CRTA's work and specific reports.

<sup>83</sup> USDA Report, p. 89.

<sup>84</sup>"*Free Trade and Economic Cooperation Agreements Including Bilateral and Regional and Related WTO Provisions*," PowerPoint Presentation on Group A Capacity Building Workshop on Trade Policy Issues sponsored by the Asian Development Bank, Singapore, March 1, 2002.

<sup>85</sup>"*Report (2002) of the Committee on Regional Trade Agreements to the General Council*," World Trade Organization, WT/REG/11, No. 02-6517, November 25, 2002, p. 2.

<sup>86</sup>*Ibid*, p. 3.



“failed so far in its task of verifying the compliance of notified RTAs with WTO provisions, due to various political and legal difficulties mainly inherited from the GATT years.”<sup>87</sup> The August, 2002 Compendium concluded that CRTA’s two “intertwined” purposes—gathering information on RTAs and assessing their compliance with GATT rules—has resulted in a “problematic tandem.”<sup>88</sup> The result, according to the Compendium, is that “the examination mechanism has persistently failed to serve these purposes adequately in the last four decades”, mainly because of members’ divergent interpretation of GATT Article XXIV’s rules.<sup>89</sup> Just last week, the new WTO Director General Supachai Panitchpakdi characterized the CRTA as being “moribund.”<sup>90</sup>

In truth, CRTA alone should not take the blame for the WTO’s legal stalemate that has resulted in RTAs neither having been sanctioned as GATT compliant nor noncompliant—or even for CRTA’s inability to produce the preliminary factual reports. WTO members themselves have been reluctant to provide information to CRTA and agree to information on RTAs that later may be used against them by a WTO Dispute Settlement Panel.<sup>91</sup> This “dispute settlement awareness” is grounded in the fact that the WTO has not established—and members have not agreed on—precisely how the WTO dispute settlement process and CRTA examinations of RTAs interface with, and impact, one another. Until this underlying issue is addressed, the CRTA is likely to continue producing reports that “merely set out the views of the [RTA] parties that the agreement is GATT-legal, and of the non-parties that it is not.”<sup>92</sup> The

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<sup>87</sup> *Annual Report of Director General*, November 15, 2002, p. 30.

<sup>88</sup> WTO August 2002 Compendium, Paragraph 16, p. 7.

<sup>89</sup> *Ibid.*

<sup>90</sup> “*The Doha Development Agenda: Challenges Ahead*,” Speech by WTO Director General Supachai Panitchpakdi for the Fourth European Union-Association of Southeastern Asian Nations Think Tank Dialogue. Speech given before the European Parliament, Brussels, November 25, 2002.

<sup>91</sup> August Compendium, P. 7.

<sup>92</sup> “*Regional Trade Organizations: Strengthening or Weakening Global Trade*,” American Society of International Law Proceedings, remarks by Amelia Porges, Senior Legal Officer, GATT Secretariat, April 7, 1994.

August Compendium notes with concern that, if left unaddressed, this issue could result in WTO litigation replacing the WTO's multilateral examination of RTAs.<sup>93</sup>

Kessie raises another deeper more, fundamental unresolved issue that is preventing the CRTA from actually taking a side in its determinations of GATT-compliance—sovereignty. To what extent should the WTO be empowered to require changes to a RTA that it deems to be illegal?<sup>94</sup> What should the WTO's role be in realigning RTAs in accordance with Article XXIV? Who in the WTO should make this momentous decision that would send RTA countries back to negotiations? If the WTO's surveillance powers for RTAs are strengthened in the current Doha Development Round, could it have the opposite effect, alienating countries from participating in the multilateral trade system and further encouraging them to pursue RTAs that are neither notified to the WTO nor compliant with Article XXIV?

#### **D. Conclusions on Article XXIV's Deficiencies**

This section has examined why WTO rules surrounding RTAs are on the current Doha agenda of multilateral trade negotiations. These rules are ambiguous, not followed, and subject to abuse by parties. Therefore, it is not surprising that that parties often don't notify the WTO of RTAs and that the WTO cannot effectively and decisively assess their compatibility with GATT rules. It is obvious from the analysis above that WTO members themselves are truly ambivalent about whether they want to sacrifice the short-term gains from RTAs for deeper liberalization achieved multilaterally.

The result of this ambivalence over the years has been that GATT rules have had little impact in governing RTAs in the multilateral trade system. To this day, for example, questions still persist as to whether Europe's Common Market, formed a half century ago, violated Article XXIV and whether its waiver from Article XXIV's rules was, in Bhagwati's words, "the

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<sup>93</sup> WTO *August 2002 Compendium*, p. 7.

beginning of the breakdown of the GATT's legal discipline, which we now seek to repair."<sup>95</sup> The intense popularity of regionalism today and the questionable level of interest in multilateralism suggest that Article XXIV may no longer serves the international economic interests of the world trading community. As we've seen, Article XXIV inadequately governs the introduction of RTAs into the world system. The fact that Article XXIV is completely silent on how RTAs should operate and function within the WTO once established<sup>96</sup> suggests that the law should be clarified, reworked, replaced, or tossed out completely.

#### **IV. Proposed Reforms to GATT Article XXIV**

The analysis so far illustrates the shortcomings of GATT Article XXIV and its lack of attention by WTO members. It is clear that reforms are needed to strengthen it, clarify it, or at least simplify what countries need to do ensure that a RTA is GATT-WTO compliant. Such simplification, according to John McMillan, an eminent economist at the Stanford University School of Business, would improve the chances that WTO members will abide it. *"Any law that is rarely complied with is a bad law,"* said McMillan. *"A rule that was, on the other hand, simple and perceived to be fair would have a reasonable chance of being obeyed by GATT members."*<sup>97</sup>

So what is being done in the Doha negotiations to clarify Article XXIV? Not much—so far at least. Since last November's ministerial, a few WTO members have taken the initiative to begin discussions on *"negotiations aimed at clarifying and improving disciplines and procedures under the existing WTO provisions applying to regional trade agreements,"* as the Doha

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<sup>94</sup> Kessie, p. 41.

<sup>95</sup> Bhagwati, *"Regionalism and Multilateralism: An Overview"*, p. 8.

<sup>96</sup> *"Breaking the Barrier Between Regionalism and Multilateralism: A New Perspective on Trade Regionalism,"* Harvard International Law Journal, Summer 2001, by Sungjoon Cho, President and Fellows of Harvard College., 42 *Harv. Int'l L.J.* 419, 421.

<sup>97</sup> McMillan, p. 15.

Ministerial Declaration promised.<sup>98</sup> Australia and the EU, for example, have submitted proposals to the WTO, which are reviewed next, but neither are likely to generate meaningful reforms. These discussions are taking place in the WTO's Rules Negotiating Group (RNG).<sup>99</sup> So far, the discussions have failed to promote any serious effort at reform. WTO members remain stuck in disagreements on how to even begin framing the negotiations around Article XXIV's procedural requirements, much less making progress on the thornier, substantive issues. Members also cannot decide if they want to amend Article XXIV, reach another "Understanding on the Interpretation of Article XXIV," as was done at the conclusion of the Uruguay Round,<sup>100</sup> or perhaps find some other means to address the problem.

Although numerous WTO members over the years have requested that the WTO clarify the meaning of Article XXIV, only two members—Australia and the European Union—have submitted formal proposals to the WTO on this issue.

**A. Australian Proposal<sup>3</sup>/<sub>4</sub> Redefine Article XXIV:8's "Substantially All Trade" Rule to Include All Sectors Via a Numerical Test**

On July 10, 2002, Australia submitted to the WTO a proposal that would modify Article XXIV:8's "substantially all the trade" (SAT) rule to require that RTA members establish that the RTA has satisfied a numerical test that would prevent the agreement from excluding large

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<sup>98</sup> Doha WTO Ministerial 2001: Ministerial Declaration, Paragraph 29, WT/MIN(01)/DEC/1, Adopted on 14 November 2001.

<sup>99</sup> "Regionalism Talks Lag as Major Players Display Lack of Enthusiasm," Inside U.S. Trade, August 30, 2002.

<sup>100</sup> *Ibid.* In 1994, the Uruguay Round concluded with an "Understanding on the Interpretation of Article XXIV" (UR), which addressed in a cursory manner a few of the many contentious issues surrounding the statute. For example, the UR stipulated that XXIV:5's general incidence test (discussed earlier on page 10) be based on an overall assessment of weighted average tariff rates and applied, rather than bound, tariffs. See UR Understanding, Paragraph 2. The Understanding, however, didn't really accomplish much because it (1) focused mainly on tariffs while not addressing other forms of trade barriers and (2) it merely reemphasized the importance of the WTO Council for Trade in Goods (CTG) in reviewing RTAs. See Cho, p. 444-445. As mentioned on page 20, the CTG in 1996 was replaced by CRTA because of the CTG's ineffectiveness in reviewing RTAs. And, as was discussed on page 21, CRTA has failed to accomplish its objectives. Thus, the UR did little to rectify Article XXIV.

sectors of trade.<sup>101</sup> Australia's proposal would set a numerical test based on six-digit tariff lines of the Harmonized Tariff Schedule (HTS). RTAs would have to demonstrate that they meet this numerical benchmark in terms of intra-RTA liberalization to satisfy the SAT requirement. Otherwise, the CRTA would not approve the RTA.<sup>102</sup> Although Australia did not specify a percentage in the proposal, it previously set a 95% benchmark in a 1998 proposal to CRTA.<sup>103</sup> However, Australia chose to base the test on tariff lines rather than trade volumes because, it argued, this would make it easier for the CRTA to evaluate a RTA's compliance prior to its implementation. A trade volume approach, Australia contended, would be difficult to measure since trade volumes change over the course of a RTA's implementation.<sup>104</sup>

Australia's proposal attempts to clarify Article XXIV:8's SAT requirement to win its long-standing conflict with the EU about the EU's sectoral exclusion of agriculture under the SAT requirement.<sup>105</sup> However, the proposal—although an attempt to facilitate CRTA's analysis of this issue—did not address the systemic problems discussed earlier that surround CRTA's inability to issue decisions on RTAs. Thus, the Australian proposal is not likely to accomplish much even in the unlikely event that the proposal is adopted in the Doha negotiations.

## **B. European Union Proposal<sup>3</sup>/<sub>4</sub> Promote Formation of “Deep Integration” RTAs**

In early July, the EU countered Australia's proposal with one that favors a trade volume approach. Unlike the Australian proposal, however, the EU's proposal is relatively silent on the SAT requirement. In fact, the EU proposal doesn't attempt to address Article XXIV's systemic shortcomings, other than emphasizing that the WTO legal framework for RTAs needs to be

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<sup>101</sup> “*EU, Australia Offer Competing Proposals on Regional Deals*,” Inside U.S. Trade, August 2, 2002. See “*Submission on Regional Trade Agreements by Australia*,” Negotiating Group on Rules, World Trade Organization, TN/RL/W/15, July 9, 2002.

<sup>102</sup> *Ibid.*

<sup>103</sup> *Id.*

<sup>104</sup> *Id.*

<sup>105</sup> See earlier discussion of this issue on page 15.

clarified.<sup>106</sup> Instead, the EU proposal distinguishes between two types of RTAs: (1) classic RTAs that merely liberalize tariffs and (2) “deep integration” RTAs that go deeper by eliminating non-tariff barriers and harmonizing regulatory standards among RTA members.<sup>107</sup> The EU in the proposal favors deep integration RTAs because forming them would make discrimination against third parties “objectively difficult and economically meaningless.”<sup>108</sup> The EU proposal also would allow developing countries the flexibility to take on lesser commitments in RTAs (for example, with longer phase-in periods for reductions in tariffs).<sup>109</sup>

The problem with the EU’s approach is that it is seen by some in the WTO Rules Negotiating Group (RNG) as being too general and not connected to reforming RTA rules. Instead, they see it as a more conspicuous way for the EU to negotiate more agreements with developing countries under the guise of RTAs rather than under unilateral preference arrangements (UPAs).<sup>110</sup> Under UPAs, the EU has to secure a unanimous waiver from all WTO parties under GATT Article I’s “Most Favored Nation” clause. This process is a burdensome, time-consuming, and costly one. Some in the RNG feel that the EU’s proposal simply represents an attempt by the EU to avoid having to secure UPA waivers.<sup>111</sup>

At a CRTA meeting following the EU’s submission of its proposal, Australia’s Ambassador to the WTO, David Spencer, told CRTA that it is ironic that the EU was now attempting to reform RTA rules given the EU’s high-level of interest in negotiating RTAs,

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<sup>106</sup> Inside U.S. Trade article, August 2, 2002. See “*Submission on Regional Trade Agreements by the European Communities and Their Member States*,” Negotiating Group on Rules, World Trade Organization, TN/RL/W/14, July 9, 2002.

<sup>107</sup> *Ibid.*

<sup>108</sup> *Id.*

<sup>109</sup> *Id.*

<sup>110</sup> *Id.*

<sup>111</sup> *Id.*

especially with developing countries.<sup>112</sup> Spencer reportedly asked the CRTA rhetorically if the EU was attempting to “shut the barn door after the horses have bolted.”<sup>113</sup>

Although Australia and the EU are the only WTO members that have advanced specific proposals, other members have emphasized to the WTO the need to reform and clarify Article XXIV. Last week, for instance, Turkey informed the WTO that it favors a quantitative approach for a RTA to comply with Article XXIV:8’s SAT requirement.<sup>114</sup> Japan and Hong Kong have urged the WTO to apply a stricter interpretation of the word “substantial”, arguing that XXIV:8 should require up to 95 percent of intra-RTA trade and that WTO members such as the EU should not be able to “pick and choose” sectors they want to exclude from RTAs.<sup>115</sup>

A major issue that has surfaced thus far in these preliminary discussions is whether changes and clarified rules on RTAs should apply to existing RTAs, or only to new ones. Countries that favor applying changes to existing RTAs include Japan, Korea, Hong Kong, Australia, New Zealand, India, and Pakistan.<sup>116</sup> Most WTO countries are against the retroactive application of new disciplines on RTAs.<sup>117</sup>

The U.S. has not taken a formal position on whether Article XXIV should be amended.<sup>118</sup> Although it welcomed the Australian and EU proposals, the U.S. has raised several questions about both proposals, including whether the EU believes that any reforms to Article XXIV

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<sup>112</sup> “*EU, Australia Seek to Spur Progress on WTO Vetting of Regional Trade Pacts*,” WTO Reporter, Bureau of National Affairs, by Daniel Pruzin, July 11, 2002, p.2.

<sup>113</sup> Ibid.

<sup>114</sup> “*Submission on Regional Trade Agreements, Paper by Turkey*,” Negotiating Group on Rules, World Trade Organization, TN/RL/W/32, No. 02-6502, p. 3.

<sup>115</sup> “*WTO Countries Wrestle with Rules on Regional Agreements*,” Inside U.S. Trade, October 19, 2001.

<sup>116</sup> Ibid.

<sup>117</sup> “*WTO Members Step Up Work on Rules on Regional Trade Deals*,” Inside U.S. Trade, June 14, 2002.

<sup>118</sup> An Inside U.S. Trade article in August (“*Regionalism Talks Lag as Major Players Display Lack of Enthusiasm*,” Inside U.S. Trade, August 30, 2002) reported that the “U.S. appears to be uninterested in negotiating new rules on RTAs and instead prefers Article XXIV issues be addressed by WTO dispute settlement panels.” It also suggested that Washington was “cold” to the idea of RTA reform. I have discovered no evidence to suggest that this characterization of the U.S. position on RTAs has any

should apply to existing RTAs.<sup>119</sup> No proposals or communications to the WTO by Washington have been submitted on this issue so far. Since the President signed the Trade Act of 2002 in August, the U.S. has made the pursuit of RTAs its number one priority in U.S. trade policy. In remarks before the National Press Club in October, for example, U.S. Trade Representative Ambassador Robert B. Zoellick set out a ten-point plan for the new U.S. trade agenda. The first four of these points involve pursuing free trade agreements with Chile, Singapore, Morocco, Australia, Central American countries, and Southern African nations.<sup>120</sup> The tenth point in Zoellick's agenda was to push for new membership in the WTO by Russia and developing countries.<sup>121</sup>

### C. Other Proposals

In addition to the EU and Australia proposals, there have been suggestions from academia on these issues. These include strengthening not only Article XXIV's language, but also the powers of the WTO bodies examining RTAs, including CRTA. Jeffrey A. Schott concludes that the CRTA "cannot maintain oversight of [RTAs] in real time" and recommends that WTO representatives be assigned to work with regional trade organizations such as the Economic Commission for Latin America and Caribbean, the Organization of American States, the Transatlantic Business Dialogue, and the APEC Secretariat.<sup>122</sup> Schott argues that WTO staff could serve both as an information source for these RTAs' compliance with WTO rules and a monitor for these RTAs' progress in meeting requirements of GATT Article XXIV. Schott

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accuracy, other than the fact that the U.S. has (so far at least) been relatively silent on RTA reforms and has yet to submit a formal proposal to the WTO.

<sup>119</sup> "EU, Australia Seek to Spur Progress on WTO Vetting of Regional Trade Pacts," WTO Reporter, Bureau of National Affairs, July 11, 2002, by D. Pruzin.

<sup>120</sup> "Globalization, Trade, and Economic Security," Remarks at the National Press Club, Robert B. Zoellick, U.S. Trade Representative, October 1, 2002, pps 9-10.

<sup>121</sup> *Ibid.*

<sup>122</sup> "Launching New Global Trade Talks: An Action Agenda," Institute for International Economics, Washington, D.C., September 1998, Jeffrey J. Schott, p. 16.



further argues that the WTO CRTA could help to coordinate and reinforce multilateral trade reforms of major regional deals such as APEC and FTAA, both of which are expanding.<sup>123</sup>

Raj Bhala of George Washington University has suggested that the WTO Appellate Body could take a stronger role in managing ill-equipped GATT provisions such as Article XXIV. Bhala argues that the Appellate Body could, via a report or set of reports, set important judicial precedent in defining ambiguous language in Article XXIV.<sup>124</sup>

Bhagwati suggests that, at the time of Article XXIV sanctioning, one price to be paid should be "the simultaneous reduction of external tariff (implicit and explicit), pro rata to the progressive elimination of internal trade barriers."<sup>125</sup> He also suggests indirect options, including modifying Article XXIV to rule out RTAs with diverse external tariffs (free trade agreements) by members and permit only RTAs with common external tariffs (customs unions). Bhagwati argues that this would most likely ensure a reduction in tariffs. He also suggests insisting on customs unions, but also writing into Article XXIV "the requirement that the lowest tariff of any union member on an item before the union must be part of the common external tariff of the union."<sup>126</sup> Some scholars have suggested that RTA members liberalize to reduce diversion and induce trade creation with nonmembers. Bhagwati has suggested a RTA's common external tariff be bound at the minimum for each of the RTA's tariff headings, although this is such a demanding test, it may not be feasible.<sup>127</sup>

Another approach would be a case by case evaluation of a RTA's compliance with the GATT aim of net-trade creation. McMillan (1991) proposed a simple test on whether the RTA results in less trade between member and outside countries. McMillan argues that a more

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<sup>123</sup> Ibid.

<sup>124</sup> "The Power of the Past: Towards De Jure Stare Decisis in WTO Adjudication (Part Three of a Trilogy)", George Washington International Law Review, 2001, Symposium on Global Trade Issues in the New Millennium, p. 924.

<sup>125</sup> Bhagwati, *Regionalism and Multilateralism; An Overview*," p. 16.

<sup>126</sup> Ibid.

straightforward approach to XXIV would not only strengthen its compliance, it makes more sense economically. The admissibility test, he suggests, is grounded in economic theory while the current rule is unsupported by economic fundamentals in addition to being more complicated.<sup>128</sup> Although not perfect, Bhagwati regards McMillan's proposal as "ingenious" and argues that some version of McMillan's test could replace in Article XXIV the proviso "the current requirement not to raise the average external tariff."<sup>129</sup>

The problem with these proposals—however noble—is that they not likely to ever see the light of day in the WTO.

## **V. Analysis of Changes to Article XXIV Are Unlikely due to Outweighing Interests in Regionalism and WTO Institutional Barriers**

The gap between the problems around Article XXIV and potential reforms is enormous. The few proposals discussed above might as well be tantamount to trying to "boil the ocean". There are three major factors that are likely to prevent overhauls to Article XXIV, even if more concrete proposals emerge from WTO members. First the WTO lacks the needed support for changes by major players in the WTO, namely the U.S. and the European Union. Secondly, even if such support were present, it is institutionally difficult to make changes to WTO rules. Finally, the weak, ambiguous Doha mandate is unlikely to focus the needed attention to make changes. Each is explored below.

### **A. Major WTO Countries Do Not Support Fundamental Reform**

Any serious reforms to WTO rules would have to be advanced and supported by the WTO's two biggest players—the EU and the U.S. Since last November, efforts toward implementing the Doha Agenda has lost significant momentum as the U.S. and EU have launched aggressive campaigns to negotiate new RTAs. Japan, which has traditionally supported

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<sup>127</sup> "Trade Blocs," Published for the World Bank, Oxford University Press, New York, New York, 2000.

<sup>128</sup> McMillan, p. 15.

the WTO and strayed away from RTAs, has set out a new, rigorous strategy for pursuing a host of RTAs. In October, for example, Japan's Ministry of Foreign Affairs, Economic Affairs Bureau, issued a statement indicating its new emphasis on regional initiatives. A major reason, Japan cited, is the fact that the EU and U.S. have pursued policies aimed at creating large-scale regional trade initiatives. Japan asserted that *"the current round of WTO negotiations could be the last multilateral trade negotiations prior to the creation of these large-scale integrated regional frameworks."*<sup>130</sup> In light of this, Japan concluded, *"it is necessary for Japan as well to address not only WTO negotiations, but also FTA trends in strengthening its economic relationships with other countries."*<sup>131</sup>

The ambivalence by the U.S. and EU on Article XXIV reforms is driven by two competing policy interests. On the one hand, both would like to see clarification of RTA rules so that they aren't excluded from any new regional pacts. On the other hand, such reforms could negatively impact the array of existing RTAs that both the US and EU have pursued and are pursuing.<sup>132</sup> As stated earlier, the WTO's inability to determine whether RTAs comply with Article XXIV is essentially a reflection of members not wanting to be harnessed by Article XXIV and not wanting to risk incriminating themselves in future dispute settlement cases. Bhagwati has eloquently articulated this fear by stating that asking WTO members to adhere to Article XXIV "is like asking criminals to decide on their own sentencing."<sup>133</sup>

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<sup>129</sup> Bhagwati, *"Regionalism and Multilateralism; An Overview,"* p. 18.

<sup>130</sup> *"Japan's FTA Strategy (Summary)"*, Japanese Ministry of Foreign Affairs, Economic Affairs Bureau, October, 2002.

<sup>131</sup> *Ibid.*

<sup>132</sup> *"Regionalism Talks Lag as Major Players Display Lack of Enthusiasm,"* *Inside U.S. Trade*, August 30, 2002.

<sup>133</sup> As quoted on page 7 of *"Securing the Peace Dividend in the Middle East: Amending GATT Article XXIV to Allow Sectoral Preferences in Free Trade Areas,"* *Michigan Journal of International Law*, Spring 1997, David R. Karasik. Footnote 84. *"AEI Book Summary, The Economics of Preferential Trade Agreements,"* (Jagdish Bhagwati & Arvind Panagariya, eds., January 1997.)

Against this backdrop, it's tough to imagine that the US and EU are likely to push for Article XXIV reforms. The evidence suggests the opposite. The promotion of RTAs, not their governance, is topping the agenda.

## **B. Reform in the WTO is Institutionally Difficult**

Even if the U.S. and EU favored substantive changes to Article XXIV, there are formidable institutional obstacles that would prevent the reforms from taking place. Changes in the WTO are not easy. What challenges and hurdles must be overcome for the WTO to reform its rules on RTAs?

In an email, Edwini Kessie indicated that any WTO Council (in this case, the Council on Trade in Goods) could initiate a proposed amendment to WTO rules under Article X of the Marrakesh Agreement establishing the WTO. Consensus among WTO members, he indicated, would have to be achieved to modify Article XXIV and other rules relating to RTAs such as Article V of the General Agreement on Trade in Services, and the Enabling Clause. WTO members could also make a change to the Understanding on Article XXIV of the GATT 1994 or could resort to a formal amendment if there is a consensus. They could also adopt a decision on the application of GATT Article XXIV.<sup>134</sup>

The problem, Kessie points out, is twofold. One is reaching an agreement on which rules need amendment. This is, in his view, the greatest challenge in amending GATT XXIV—agreeing on what to amend. He points out that reaching a vote to effectuate changes to WTO rules is extremely difficult because WTO members—each with distinct, separate, and unique and often conflicting interests in any one issue—must reach a consensus, but voting to

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<sup>134</sup> Email to Donald A. Calvert from Edwini Kessie, Counsellor, Council & Trade Negotiations Committee, World Trade Organization, Geneva, Switzerland, November 4, 2002.

determine such a consensus seldom occurs. It's a recipe for gridlock to making changes, or as he says "*it is virtually impossible to obtain the required consensus to amend a WTO provision.*"<sup>135</sup>

Bhala (2001) has acknowledged the limitations in WTO institutions' ability to rectify obsolete law. He has indicated that the WTO system has yet to officially recognize the doctrine of stare decisis, the absence of which truncates the legal force of the Appellate Body's decisions: "*Its decisions about how to interpret statutes, and how statutes fit together, remain technically only one-shot, unconnected transactions.*"<sup>136</sup> The absence of such stare decisis, he argues, renders panel and Appellate Body reports as lacking any legal teeth. The other bodies that could effectuate such a change—the WTO Ministerial Conference and the General Council—are, according to Bhala, making every effort to avoid becoming the "legislature of the world trade system".<sup>137</sup> The reasons for not being able to look to WTO institutions to update statutes, according to Bhala, is that the WTO Conference and Council are politically paralyzed and are slow, bureaucratic institutions that are hindered by internal procedural disputes. The root of all of these barriers, he argues, may be a fear among WTO Members of surrendering more layers of sovereign legislative power to the WTO.<sup>138</sup>

### **C. Weak Doha Mandate Won't Strengthen Rules**

Finally, reform efforts will be hindered by the Doha Declaration's mandate, which is extremely weak. Asking that the WTO "clarify the existing rules"<sup>139</sup> has been attempted for years and persistently failed. The 1994 Understanding, for example, did little to clarify RTA rules. In the ongoing negotiations, members have yet to agree on how begin negotiating the non-

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<sup>135</sup> Ibid.

<sup>136</sup> Bhala, p. 925.

<sup>137</sup> Ibid.

<sup>138</sup> Id.

<sup>139</sup> Doha Declaration, Paragraph 27.

substantive, procedural problems and have yet to take a direction on the thornier, substantive issues.

What are the implications if no changes are made to GATT Article XXIV or other RTA rules in the current round of trade talks? Kessie's concern is that the WTO's current inadequate legal-institutional framework would remain and the legal problems surrounding RTAs would only grow as RTAs continue to proliferate. *"That in turn would mean that there would be differing interpretations of the relevant rules of the WTO and the paralysis in the decision-making process to determine whether a regional trade agreement is consistent with WTO rules,"* Kessie says. *"My own view is that it would be a missed opportunity if WTO Members do not take advantage of the negotiations to strengthen both the procedural and substantive rules relating to regional trade agreements."*<sup>140</sup>

Last week, in a speech for the European Parliament, WTO Director General Supachai Panitchpakdi voiced his concern about RTAs diverting limited resources away from multilateral negotiations. He concluded that a failure to strengthen Article XXIV *"will be to the detriment of all members...but small countries which already suffer from limited negotiating leverage and capacity will be disproportionately affected."*<sup>141</sup> Supachai encouraged WTO members to exercise courage, leadership, and flexibility. *"A meaningful effort has to be made in the Doha negotiations to redraw the balance between regionalism and multilateralism...The future prospects of many, many people depend on it."*<sup>142</sup>

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<sup>140</sup> Kessie email to Donald Calvert.

<sup>141</sup> *"The Doha Development Agenda: Challenges Ahead,"* Speech of WTO Director General Supachai Panitchpakdi, European Parliament, Brussels, Fourth EU-ASEAN Think Tank Dialogue, November 26, 2002.

<sup>142</sup> Ibid.

## **VI. Conclusion**

The world trade system is at a moment in history where it is seeking on one level to redefine and clarify the rules governing the existence of regional trade agreements within the multilateral system. At a deeper level, it is also struggling to establish a new, synergistic relationship between regionalism and multilateralism—one that yields the maximum benefits both routes toward trade liberalization can offer while, at the same time, preventing the functioning of one from damaging the other.

The problems and issues surrounding RTAs and GATT Article XXIV are symptoms of a larger, more systemic problem—interest in regionalism at the moment appears to be strongly outpacing the interest in multilateralism, the latter of which, one could argue, is—if not waning—limping forward. If trade policymakers are to address this sensitive and difficult issue, then the more fundamental, unresolved questions that are fueling the trade community's ambivalence and disregard for Article XXIV must be addressed. What is the real, long-term interest of WTO members in the multilateral system? Are they willing to forsake some of the short-run gains from regionalism in order to achieve the deeper, more-systemic economic and political rewards that result from nondiscriminatory, multilateral free trade?

The fact that this issue was placed on the Doha Development Agenda is a positive sign. However, the difficulties in making meaningful changes to the Article XXIV framework are likely to prevent the changes from seeing the light of day. Hopefully, under the WTO's new leadership and in the course of the Doha Round, world trade policymakers will see the importance—and means—to reconcile the hurdles and contradictions posed by regional trade agreements within the world trade system.

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