

If I don't do it, somebody else will (or won't)

(Testing the compliance of PTAs with the multilateral rules)

by

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Abstract

Economic theory asks the question what are the welfare implications of any preferential trade agreement (PTA) before it pronounces on its merits. Although, one cannot exclude that a PTA is welfare enhancing (or welfare deteriorating), some economists usually view them with skepticism. The same skepticism is evidenced in the regulatory regime. In the absence of 'open clubs', PTAs are per construction antithetical to the idea of non discriminatory trade, the cornerstone of the WTO edifice. The WTO regime however, does not outlaw them outright: instead, PTAs can be judged consistent with the multilateral rules, assuming that they have adhered to the relevant legal regime. The legal test for consistency of a PTA with the WTO only tangentially, if at all, addresses their welfare implications. A look into practice shows a proliferation of PTAs over the recent years. Their proliferation however, *de facto* has not been conditioned on a prior satisfaction of the relevant legal regime. The consistency of PTAs with the multilateral rules will be established before the CRTA (Committee on Regional Trade Agreements, where all PTAs have to be notified) and, eventually, before WTO panels. In practice, for reasons having essentially to do with the voting mechanism in the CRTA, the question of consistency of specific PTAs with the WTO has been largely left unanswered. At the same time, WTO Members have only on very few occasions challenged the consistency of a PTA with the multilateral rules before a panel, although the burden of persuasion allocated to complainants is relatively low. It seems that WTO Members often lack the incentives to contest the validity of PTAs. The reasons why in theory this is the case can vary: there is probably a collective action problem here, in that risk averse 'outsiders' (WTO Members not participating at all in PTAs) might prefer not to challenge PTAs; those participating in PTAs, also rationally, might prefer to stay idle in fear that their own legal actions might backfire against them. It is also probably true that, their competence notwithstanding, panels lack the necessary prerequisites to pronounce on such a complicated issue. As a result, a number of PTAs of questionable WTO-consistency are being 'tolerated' within the multilateral trading system. Absent legislative activity, it seems highly unlikely that the current situation will change in the near future.

1. The questions asked and the questions to ask about PTAs.

1.1 Regionalism increases as globalization progresses

Sapir (1998, p. 718) mentions that when the WTO was established all but three of its original 120 Members were parties to at least one of the 62 regional agreements still in force (the exceptions being Japan, Hong Kong, China and Korea). This seems quite paradoxical in two ways: on the one hand, one would expect that, following the substantial reduction of tariffs at the multilateral level, there would be no much argument for going regional: in a world of low protection, there is not much to gain for countries that want to further reduce existing protection. On the other hand, there is an obvious tension between “globalization” –notwithstanding the abusive manner that the term is currently used--, and regionalism: it cannot be that countries simultaneously pursue the “global” and the regional perspective.¹

Both paradoxes could be explained though, assuming that ‘regionalism’ is not pursued solely for commercial (trade) purposes. It could very well be the case that regionalism is the expression of the political will to ‘lock in’ policies and take distance from past ‘sinful’ behaviour (although this has not necessarily always been the case). Thus, going regional could serve as signaling mechanism for those participating in such a scheme. This is what, at least partially, pushed Mexico to join NAFTA. Such an explanation is not at odds with the current shaping of the WTO contract: the GATT/WTO regime does not provide a safe ‘lock in’ for domestic policies: with the exception of TRIPs, the WTO remains essentially a negative integration-type of contract which does not impose common policies on its membership.²

¹ The official WTO website (www.wto.org) shows that PTAs have almost doubled since the coming into being of the WTO. See also Limao (2005).

² Indeed, if trade diversion was the only motive for going regional, it would seem that in a world where

The term 'regional integration' is probably misleading: in essence, what the term aims to capture are preferential schemes that deviate from the obligation not to discriminate. Not all such schemes are regional, in the sense of geographical proximity. One third of free trade areas currently under investigation are among countries that are not in geographical proximity: the number of cross-regional schemes, has risen from 6 in 1995 to 25 in 2002.³ The *European Community—Mexico*, the *Singapore—New Zealand*, and the *Mexico—Japan* free trade areas are appropriate illustrations. Economists use the term 'preferential trade agreements' (PTAs), which better reflects their objective function.

The increasing number of PTAs is a rather recent phenomenon. In absolute terms, most of the PTAs notified to the WTO came into being after 1993. Historically, the European Community championed the establishment of PTAs. Many reasons help explain this trend, but two stand out as probably the dominant explanations:

- (a) some of the partners were candidates for accession (and a preferential scheme was thought to be the antechamber to the European Community), or ex-

customs duties are quite low, there would be less incentive for governments to exercise this option. Irwin (1996) argues that duties calculated on dutiable imports stood at 19.34% in 1947 and 13.87% in 1948. However, were one to include duty free trade, the ration of duties collected to total imports amounted to 7.55% in 1947 and 5.71% in 1948. The average tariffs on dutiable imports (weighted with the 1939 trade values) in 1947 was 32.2% and 25.4% in 1948. As 60% of US imports was duty free in 1947, the average tariff for total imports were much lower. In addition, were tariff averages to be weighted with the 1947 trade weights (and prices and not with 1939 values) then the post-Geneva average tariff on dutiable imports drops from 25.4% to 15%. Including duty free imports, the pre-Annecy (GATT 1948) tariff average of all US imports was estimated by the US Tariff Commission to amount to 5.9%. This number fits almost unbelievably well with the ration of duties calculated to total imports (free and dutiable) of 5.97% in 1950. In practice however, the proliferation of PTAs coincides with the period of (relatively) lower tariff protection. It could be of course, that through PTAs WTO Members address non tariff barriers (NTBs), or, conversely, that trade diversion takes place through NTBs. There is evidence of the latter (Serra, 1997 who concludes that rules of origin represent a formidable obstacle to trade creation), and, except for the European Community, almost no evidence of the former.

³ Source: World Trade Report 2003, WTO publication: WTO, Geneva.

colonies of individual European Community members, with which, it was felt, some form of preferential trade should be established;

- (b) trade policy was the only 'genuine' common policy of the European Community in the realm of international relations: signing trade deals with various partners carried an inherent positive externality, in that it affirmed the European *persona* as one entity in the eyes of the world. A number of constituencies favoured this demarche.

The example of the European Community was, in the nineties, emulated by the United States which signed a series of agreements with states in the American continent: it started with the free trade area with Canada, it moved to NAFTA and has culminated in negotiations for the FTAA (Free Trade Area of the Americas).⁴

1.2 An economist and a lawyer looking at a PTA: two ships passing by in the night

Economists have initially viewed regional integration with skepticism: such schemes both create and divert trade, and for a number of reasons (ranging from political motives to adverse selection), empirical evidence supported the thesis that the latter, in practice, outweighed the former.⁵ This does not however, mean that all PTAs are welfare reducing. First, it could very well be the case that the welfare implications are positive: indeed as the Kemp-Wan theorem shows, trade diversion can be eliminated by reducing external tariffs so as to keep trade with non-members to a PTA unchanged (keeping, in other words, prices constant).⁶ Second, the perspective matters: it could be that schemes

⁴ FTAA covers all states in the American continent from Canada to Argentina, with the exception of Cuba. The negotiations, at the moment of writing, were ongoing.

⁵ See the empirical evidence reflected in the World Trade Report, op. cit, in pp. 52ff. See also the excellent analysis in Winters (1996).

⁶ The result in the Kemp-Wan theorem applies in a set of given circumstances (and it is not clear how large

which are not welfare-maximizing from a world perspective, nevertheless, make those participating in them better off. In short, although it is probably legitimate to approach PTAs with suspicion, economists will inquire into their welfare implications before pronouncing on the issue of whether they should be welcome or not.

On the other hand, the motives⁷ for entering into such schemes vary: it could be that some countries, frustrated with the slow pace of liberalizing trade at a multilateral level, use PTAs as a second best; it could also be, as indicated with respect to Mexico's participation in NAFTA, that such schemes are 'signaling mechanisms'. It cannot be excluded however, that recourse to PTAs is privileged because the country at hand lacks the productivity-rate that would allow it to compete on the international plane. Finally, it is probably worth recalling that, at least initially, PTAs were truly regional.

Geographic distance and cultural factors might deter trade, and there are good reasons to believe that geographic proximity coupled with cultural affinity (a rather frequent combination among regional partners) goes in the opposite direction.

Preferential arrangements can regard trade in goods (GATT) and/or trade in services (GATS). The GATT legal system does not enquire into the motives of countries entering into PTAs; it does not care about welfare implications either. It simply aims to make departures from MFN onerous. The relevant GATT provision is Art. XXIV GATT. It allows WTO Members to form free-trade areas (FTAs) and customs unions (CUs) to the extent that they respect the disciplines laid down in this legal provision. A customs union is a free trade area where the member states have, in addition to free trade among themselves (which is what an FTA amounts to), the same external tariff-regime for imports from countries that are not members of the customs union.

the set is). It is not a universally true result in any sense. On the other hand, the Kemp-Wan theorem is not a *passage oblige* in order to support a claim that PTAs are not necessarily welfare-reducing.

Art. XXIV GATT lays down substantive requirements that serve as the legal benchmark to review the consistency of a FTA or a CU with the multilateral rules. They are distinguished between an internal- (Art. XXIV.8 GATT), and an external requirement (Art. XXIV.5 GATT). WTO Members, further incur an obligation to notify to the WTO their imminent FTA or CU (Art. XXIV.7 GATT).

Art. V GATS lays out the conditions to be filled for a PTA to be GATS-consistent.⁸ Since there is no provision in the WTO Agreement obliging WTO Members wishing to conclude a FTA or a CU, to simultaneously satisfy the requirements of Art. XXIV GATT and of Art. V GATS, it is perfectly legitimate that WTO members opt for regional schemes in either the goods or the services sector.⁹

1.3 Organization of the paper

The rest of the paper is divided in follows: In Section 2, a brief description of the legal test is being provided. Section 3 is dedicated to the twin issue who in the WTO has the task to pronounce on the consistency of PTAs with the multilateral rules: the multilateral and the bilateral routes are being identified. In Section 4, an attempt is made to explain that the multilateral route has, in the overwhelming majority of the cases, failed to produce an outcome, whereas the bilateral route, although promising, has not delivered

⁷ On this score, see the excellent analysis of Mattli (1999).

⁸ Since not even one single review of a PTA has been completed in the GATS-context, in the remaining part of the paper I will deal only with PTAs in the GATT-context. At the moment of writing, there are five reported cases where the factual examination has been completed, and three reported cases where consultations on the draft report are being held but not one single report has been adopted as yet.

⁹ On this score, see Mavroidis (2005) who argues that since non discrimination is not a WTO-, but a GATT- and a GATS-principle, the only rational construction is that WTO Members can legitimately enter into a goods-only or a services-only PTA (WTO Members remaining free, but not being obliged to, enter into a goods cum services PTA).

either. Section 5 lays out the probably more important reasons explaining why the bilateral route has been under-used. Section 6 briefly recaps the main conclusions.

In this paper, I deal with PTAs formed under Art. XXIV GATT. As stated above, PTAs can also be formed under Art. V GATS but, for the reasons mentioned, are left outside the purview of this paper. On the other hand, this paper does not cover PTAs formed to promote development of developing countries either (usually referred to as ‘south-south cooperation’). This is a possibility under §2c of the *Enabling Clause* (L/4903 of 28 November 1989), and 21 such schemes have so far been notified to the WTO.¹⁰ The rest of the paper is relevant for the study of the 112 notified PTAs (101 FTAs, and 11 CUs).¹¹

2. The legal test of consistency of a PTA with the WTO in a nutshell

2.1 No per se inconsistency

Art. XXIV.4 GATT makes it plain that PTAs can happily co-exist within the multilateral (WTO) edifice. It reads in this respect:

“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.”

Hence, this provision opens the way for WTO-consistent PTAs. The specific conditions are laid down in Arts. XXIV.7, XXIV.5/6 and XXIV.8 GATT.

2.2 The Art. XXIV GATT Test in a Nutshell

¹⁰ According to the information provided in the WTO official website (www.wto.org).

Art. XXIV GATT distinguishes between two forms of PTAs: customs unions (CU) and free trade areas (FTA). There is an overlap between a CU and an FTA: parties to the agreement will have to liberalize substantially all trade between them. The difference between these two forms of regional integration is that in the case of a CU, contrary to what happens in an FTA context, there is provision for a common external policy as well.

Art. XXIV GATT imposes three obligations on WTO Members wishing to enter into a PTA, the first of a procedural, and the latter two of substantive nature:

(i) an obligation to notify the PTA. Since regional integration essentially amounts to an exception from the basic obligation to treat international trade in a non-discriminatory manner, the resulting legal consequence is that WTO Members wishing to enter into a PTA, and consequently deviate from the obligation to treat trade from all other WTO Members in a non-discriminatory manner, will have the burden of proof to state that they have complied with the relevant multilateral rules. The first step towards meeting this obligation comes with the notification of the scheme;

(ii) an obligation to liberalize among constituents of the PTA substantially all trade (internal requirement); and

(iii) an obligation not to raise the overall level of protection and make access of products of third parties not participating in the PTA more onerous (external requirement).

¹¹ Source: www.wto.org

3. Designed at home, approved (?) in Geneva

3.1 *Two tracks available to review the consistency of FTAs and CUs with the WTO*

There are two possibilities available in the WTO to review the consistency of a PTA with the multilateral rules. First, the **multilateral** perspective: WTO Members have to notify PTAs they enter into to the WTO Committee on Regional Trade Arrangements (CRTA) (Track 1)¹². Second, the **bilateral** perspective: WTO Members may challenge the consistency of a PTA with the multilateral rules through panel proceedings under the DSU (Track II). The substantive requirements (see *supra* in Section 2.1) for reviewing consistency of regional schemes are identical in Track I and Track II.

The WTO contract (Art. XXIV GATT) does not put into question the *rationale* for going regional: the rationale for going regional is a sovereign, political decision. What is put into question by the WTO contract is the conditions under which a PTA can legitimately be formed.

3.2 *The size of the problem*

As already briefly explained, a lawyer and an economist have a different perspective when looking at PTAs. Undeniably, there are more PTAs now than before: in recent, as a result of the proliferation of preferential schemes, preferential trade share of intra-PTAs trade in merchandise imports rose (at the world level) from 43.2 to 51.2% (from 2000 to 2005).¹³ However, unless the welfare implications of PTAs have been quantified, economists will not speak of a problem.

¹² The CRTA represents the ‘institutional consolidation’ of the notorious Art. XXIV Working Parties which would be established on an *ad hoc* basis to review the consistency of any given PTA with the GATT rules. In the rest of the paper, when referring to CRTA-practice, I will include the Art. XXIV Working Parties-practice as well. On the coming into being of the CRTA, see Mavroidis (2005).

The quantification however, presupposes some benchmark. Typically, the way to measure trade diversion is by comparing the *ex post* (creation of the PTA) to the *ex ante* situation, or even to a situation where the lower, preferential rate is applied on a MFN basis. But one might legitimately take the view that the alternative to *trade diversion* is not necessarily the *status quo* the way it appears in a context where PTAs are permitted. It could very well be the case however, that this assumption is wrong: it could be that the WTO Member concerned would not have the same MFN rate if Members were not allowed to have PTAs. Worse, it could be the case that a country would even be reluctant join the WTO in the first place if PTAs could not be formed under the same, more or less, conditions that WTO Members have practiced over the years.

For lawyers, unless good reasons can be advanced, setting aside a rule of law is in itself problematic. In the present context, through the emergence and proliferation of PTAs of questionable GATT-consistency, it is the cornerstone of the GATT edifice, the MFN obligation itself that is being set aside.

Hudec (1972, p.1362) notes:

“The seeming collapse of the MFN rules is probably the single most important cause of the present day pessimism about the GATT substantive rules.”

Hudec twenty years later (1993, p. 154) remarks:

“the GATT's somewhat benign attitude toward RAs is merely one part of this larger tolerance toward departures from MFN in general.”

Roessler (1993, p. 321) seems in agreement:

“The record under the current procedures is not encouraging. During the past three

¹³ See the World Trade Report, op. cit., at p. 48 and also Limao and Olarreaga (2004).

decades about 50 working parties have been established to examine RIAs. None of them was able to reach a unanimous conclusion on the GATT-consistency of the agreement examined ...”

4. In practice ...

4.1 *Choosing between tracks: the law*

In the past, voices have been raised as to whether a Track II should be available at all. The most eloquent proponent of a negative response to this question, has been Roessler (2000), who has argued that, for reasons having to do with the institutional balance of the WTO, a limited judicial review by WTO adjudicating bodies is the most appropriate one. A similar argument (if not identical, altogether) was raised by India in the context of its litigation mentioned *infra*. India argued that the question whether a restriction can be justified on balance of payments grounds is inherently political (borrowing from the *political question* doctrine, known in some legal orders) and this is why such issues have been entrusted to Committees and not to panels. In other words, the argument could be raised that the consistency of a PTA with the WTO is of political nature, and thus not justiciable. The Appellate Body rejected the argument by India essentially on textual grounds.¹⁴

The wording of the *WTO Understanding on Art. XXIV GATT* (adopted during the Uruguay round) seems to suggest that there should be no ambiguity on this score. In § 12 it reads:

¹⁴ See WTO Doc. WT/DS90/AB/R of 23 August 1999 at §§ 98ff. As noted above, the genuinely political question (why opt for a PTA) is not put into question at all by Art. XXIV GATT. On the other hand, it is not accidental that the body of Art. XXI GATT which deals with the security exception –probably, the only genuine political question—reads in a manner that makes it obvious that the margin of discretion rests primarily with the state invoking the exception. This is not the case of Art. XXIV GATT which acknowledges the discretion of multilateral organs to decide whether a given PTA is in conformity with WTO law.

“The provisions of Articles XXII and XXIII of GATT 1994 as elaborated and applied by the Dispute Settlement Understanding may be invoked with respect to any matters arising from the application of those provisions of Article XXIV relating to customs unions, free-trade areas or interim agreements leading to the formation of a customs union or a free-trade area” (emphasis added).

Hence, on its face, the Understanding seems to grant a large review power to WTO adjudicating bodies.¹⁵ Subsequent to the *Understanding*, WTO-practice (see *infra* under 4.3) confirms this view.

Having said that, one can legitimately ask the question, whether WTO panels are well-equipped to deal with such complicated issues. Beyond expertise, time constraints alone might prove an obstacle for panels wishing to perform a comprehensive review of a PTA. As will be shown *infra* (4.3), some GATT panels opted for a limited review of PTAs by panels, while it is very difficult (in light of the very limited practice) to confirm whether WTO panels are eager to follow the same path. The Appellate Body, at any rate, seems to espouse the view that a comprehensive review of a PTA by panels is not unthinkable.

So, the two Tracks are available, while the extent of review in the bilateral track is probably debatable. There remains one question to ask: what is the interplay between Tracks I and II? Assume, for instance, that a PTA is simultaneously before a panel and the CRTA. Can this happen? Yes, since there is no obligation to suspend panel proceedings while an issue is being discussed before a WTO Committee.¹⁶ If the CRTA

¹⁵ Roessler (2000) argues that the terms of the Understanding lean towards a restrictive understanding of its scope: the reference made is to the application of Article XXIV and not to Article XXIV GATT as such. However, even such a dichotomy were true, still a WTO panel adjudicating on an application of Art. XXIV GATT, will, inevitably, have to provide its understanding of the term reflected in this provision.

¹⁶ To complete the picture here, Art. 12.12 DSU allows the complaining party to request suspension of

by consensus concludes on the consistency/inconsistency of the notified PTA with the multilateral rules (a rather improbable scenario in light of past experience), there is good reason to believe that the panel subsequently dealing with the issue will follow the opinion reflected in the CRTA. To the extent that it can serve as guidance, we find it plausible that panels try to emulate on this score the attitude of panel on *India – Quantitative restrictions on imports of agricultural, textile and industrial products*,¹⁷ which, while dealing with a similar issue (e.g., to what extent a panel dealing with an issue which had already been decided by the WTO Balance of Payments Committee) relevantly provided in § 5.94:

“...we see no reason to assume that the panel would not appropriately take those conclusions into account. If the nature of the conclusions were binding ... a panel should respect them”.

The same should be true for panels dealing with PTA-related issues: the comprehensiveness of the review undertaken before the CRTA, the, in principle, antithetical motives those participating in the process are good reasons arguing in favour of at least a thorough examination by the panel of the reasoning and the outcome provided by the CRTA. There is however, no legal compulsion for the panel to follow a CRTA decision.

Should panels stop short of deciding whether a PTA is WTO-consistent, in case the CRTA has not pronounced on its consistency (*lis pendens*)? Such an approach, in light of today's institutional realities, is hardly recommendable. For if panels were to behave in this way, they would risk depriving WTO Members of their MFN-rights: the CRTA will

panel proceedings. This is a right bestowed upon the complainant, and not an obligation to behave in this way assuming certain contingencies (e.g., discussions of the issue before a WTO Committee) have been met.

¹⁷ See WTO Doc. WT/DS90/R of 6 April 1999.

invariably take a long time to reach consensus, and, as practice shows, the consensus will, in all likelihood, reflect an agreement to disagree.¹⁸

On the other hand, should the CRTA be bound by a panel's (and or Appellate Body's) decision on the consistency of a PTA with the relevant WTO rules? Now, this seems to be a likelier scenario in light of the time constraints that panels have to adhere to and the absence of such constraints when the CRTA reviews a scheme. The formal answer has to be once again, no. The legal effect of the judiciary's decision is not such that it be acknowledged the force of *res judicata* (binding any discretion of the CRTA to subsequently deviate from its reasoning/outcome).

Hence, in principle, one cannot exclude that the CRTA and a panel can reach different conclusions on the same issue. Because the former, as will be explained in what immediately follows (4.2) is unlikely to end up with a unanimous vote, in practice this possibility has never, so far, materialized.¹⁹

4.2 A largely incomplete contract

4.2.1 The terms of discontent

Art. XXIV GATT is not a self-interpreting provision. In fact, its most important terms reflecting the quintessence of the legal test upon satisfaction of which the consistency of a PTA can be proclaimed, are quite open-ended, leaving room for more than one interpretations. The terms 'restrictive regulations of commerce' and 'substantially all

¹⁸ For a relatively recent expression of a typical disagreement, see §§ 31-38 of the *Working Party report on the Free Trade Agreement between EFTA and Turkey*, adopted on 17 December 1993 (L/7336).

¹⁹ To a large extent, this is not a PTA-specific issue: the WTO contract nowhere regulates the status of 'secondary' law. This is not unusual, since the WTO agreement has not been conceived by its founding fathers to be of constitutional order.

trade' which reflect, in essence, the internal requirement, as well as the terms 'on the whole' and 'higher or more restrictive', which reflect the external requirement, are far from being unambiguous. Some legislative action has been taken and it has indeed helped to clarify some of the terms mentioned above. We will turn to this issue in Section 4.2.2. In this Section however, no exhaustive discussion of all disagreements across issues is being provided. It is meant to serve as a representative sample recapitulating the voices most often heard in the context of CRTA reviews. To the extent representative, this sample evidences the extent of disagreements among WTO Members on some key aspects of Art. XXIV GATT.

On the other hand, important terms appearing in Art. XXIV GATT have not benefited from any additional interpretation through legislative action. They have been discussed time and again in the context of the CRTA. The discussions there reflect important disagreements among the parties. The contract has failed to be completed through CRTA practice. To make matters worse, panel practice has been so scarce that the researcher will be hard pressed to find any additional guidance there either. We will turn to this discussion in 4.2.3.

4.2.2 Some legislative, clarifying action

The already mentioned *WTO Understanding on Art. XXIV*²⁰ substantially clarifies the internal requirement with respect to customs unions. It is reminded that in case a CU is being notified, the participating WTO Members will have to guarantee that the duties and other regulations of commerce shall on the whole not be higher than the general incidence of duties in place before (the advent of the CU). To ensure that this has indeed

²⁰ Panels have yet to pronounce on the legal nature of the WTO Understandings. It seems reasonable to conclude though that they constitute international agreements concluded by WTO Members and that they

been the case, Art. XXIV.6 GATT obliges the members of the CU to enter into Art. XXVIII GATT negotiations in order to compensate losers, any time they have to raise their (unilateral) duties to reach the CU-level. Essentially, the picture of protection before and after the formation of the CU have to be compared and a procedural device has been designed to address the issue whether compensation is still due, or, conversely, whether built in compensation has adequately compensated injured parties. The language used in the *Understanding* further clarifies that the quantification exercise will take place on a tariff-line basis (using applied rates) based on statistics of a prior representative period:

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

This is, so far, the only clarification through legislative action of the text of Art. XXIV GATT.

4.2.3 Practically no clarification through practice before the CRTA

should be interpreted in accordance with the Vienna Convention on the Law of Treaties.

In principle, the CRTA has unlimited powers. Art. XXIV.7 GATT relevantly reads in this respect:

“...the CONTRACTING PARTIES and shall make available...such information...as will enable them to make *such reports and recommendations to contracting parties as they may deem appropriate*’. (emphasis added).

Consequently, one cannot exclude that the CRTA concludes that a notified PTA is GATT-inconsistent. By the same token, when it comes to notified *interim agreements* leading to the establishment of a CU or an FTA, there is no ambiguity that the CRTA enjoys such wide powers. Art. XXIV.7(b) GATT reads :

“If...the CONTRACTING PARTIES find that such agreement is not likely to result in the formation of a customs union or of a free-trade area...the CONTRACTING PARTIES shall make recommendations to the parties to the agreement. *The parties shall not maintain or put into force, as the case may be, such agreement if they are not prepared to modify it in accordance with these recommendations*’ (emphasis added).

The inescapable conclusion must be that the CRTA enjoys wide powers in this respect and that conformity with its decisions is a *sine qua non* for the consistency of a PTA with the WTO rules.²¹

Yet, the CRTA did not manage to contribute much in terms of clarifying the GATT-contract. In fact, a survey of the CRTA-practice demonstrates the impossibility of WTO Members to reach workable understandings of the three requirements that could, in

²¹ One should keep in mind that, whereas the *Agreement establishing the WTO* states in unambiguous terms that WTO Agreements (primary law) are binding on the WTO Membership, it does not do the same with respect to decisions by WTO organs (secondary law). This does not mean that decisions by WTO organs are *per se* non-binding (because they are secondary law). The fact that decisions are taken by consensus (in the vast majority of cases) obviously operates as a 'legitimizing' factor in the eyes of WTO Members. Moreover, recent panel-practice shows considerable deference towards decisions adopted by various WTO Committees.

principle, be applied across the board. Many reasons could help explain why this has been the case. Without necessarily arguing that it is the dominant explanation, the voting practice in the context of CRTA goes some way towards explaining the institutional inertia in this respect. The CRTA decides by consensus. Rule 33 of the *Rules of Procedure for meetings of the CRTA* stipulates that:

“Where a decision cannot be arrived at by consensus, the matter at issue shall be referred, as appropriate, to the General Council, the Council for Trade in Goods, the Council for Trade in Services or the Committee on Trade and Development”.²²

However, practice reveals that consensus-decisions are not necessarily unanimous decisions. In practice, consensus has been relegated to a procedural requirement which is dissociated from any agreement on substantive issues; members of the CRTA will by consensus adopt decisions which reflect obvious disagreements among the members voting. Hence, it often happens that a CRTA-decision²³ reflects disagreements. By consensus, in other words, members of the CRTA adopt their agreement to disagree. Such reports might serve as inventories of future disputes across WTO Members.

There are even reported cases of Working Parties withholding judgment and not issuing a final report.²⁴ In fact, the dead end to which Working Parties routinely arrived probably explains the frustration of the Chairman of the Working party examining the consistency of the *Canada / United States Free-Trade Area* who pertinently asked:

“...what point was there in establishing a working party if no-one expected it to reach consensus findings in respect of specific provisions of such agreements, or

²² See WTO Doc. WT/REG/1 of 14 August 1996. Participation in the CRTA is open to all WTO Members.

²³ In order to avoid any misunderstandings, I repeat that references to CRTA cover references to Art. XXIV Working Parties as well.

²⁴ For example, the Working Party examining the 1973 enlargement of the then EEC to the United Kingdom, Republic of Ireland and Denmark did not issue a final report, see GATT Doc. L/5453, adopted on 9 March 1983, BISD 30S/168 at p. 174.

to recommend to the participants how to meet certain benchmarks. ... As further agreements came along, there might be a risk that they would be treated increasingly superficially and that contracting parties would lose – if they had not already done so – the ability to distinguish between agreements of greater or lesser GATT-consistency.”²⁵

Against this background, disagreements among parties as to the proper interpretation of terms should seem to be some sport of minor offense. And disagreements were many.

(a) The understanding of the external requirement

The 1983 Working Party report on *Accession of Greece to the European Communities* contains the view expressed by the European Community, that

“Article XXIV.5 required only generalized, overall judgment on this point.”²⁶

This view, however, failed to convince other members of the Working Party. By the same token, the 1988 Working Party report on *Accession of Portugal and Spain to the European Communities* contains the view of the EC that

“Article XXIV.5 only required an examination on the broadest possible basis.”²⁷

The same report though contains the view of a member of the Working Party which

“could not accept the Communities’ contention that the extension of the tariff of the EC/10 to the EC/12 was compatible with their obligations under Article XXIV.5(a) regardless of the effect on the tariffs of Spain and Portugal. Article XXIV.5(a) required a

²⁵ Excerpt re-produced in Roessler (1993, p. 322).

²⁶ See BISD 30S/168 at p. 184.

²⁷ See BISD 35S/293 at pp. 295-6.

comparison with the pre-accession tariffs of the constituent territories and the relative size of those territories was not a relevant factor.”²⁸

Disagreements appeared often among Working Party members as to whether bound or applied rates should be used in the context of Art. XXIV.5(a) GATT.²⁹

(b) The understanding of the internal requirement

According to Art. XXIV.8 GATT, WTO Members wishing to enter into a CU or an FTA will have to eliminate duties and other restrictive regulations of commerce with respect to substantially all trade in products originating the constituents of the RIA. Art. XXIV.8 GATT throughout the years has led to major controversies: Working Party members simply could never agree on the actual meaning of the terms “substantially all trade”, or “other regulations of commerce”, included in the body of Art. XXIV.8 GATT.

(i) Substantially all trade

It has been suggested, that the term has both a *quantitative* as well as a *qualitative* component, in the sense that it covers a percentage of trade and at the same time no major sector of a national economy can be excluded.³⁰ However, as is probably always the case, whereas the former facilitates communication, the latter will invariably lead to miscommunication. This is what happened in a series of Working Parties dealing with

²⁸ Idem at p. 311.

²⁹ See for example the discussions in the Working Party examining the compatibility of the EEC with Art. XXIV, GATT Doc. SR.18/4 at pp. 46-54 and also in C/M/8, SR.19/6-7; see the Working Party report on *Accession of Greece to the European Communities*, op. cit., at p. 175; see also the 1991 Working Party report on *Free Trade Agreement Between Canada and the United States*, BISD 38S/47 at p. 66. As noted above, such disagreements have been put to rest with the advent of the *Understanding on Art. XXIV*.

³⁰ The Analytical Index for example, reflects reports discussing this distinction at pp. 824-5.

this issue. The probably most appropriate way to sum up practice in this field is offered by the Working Party report on *EC - Agreements with Portugal*³¹ where the EC noted that

“there is no exact definition of the expression referring to the term ‘substantially all trade’.”

The opinion has been expressed in the *EEC Working Party* that it is

“inappropriate to fix a general figure of the percentage of trade which would be subjected to internal barriers.”³²

In the same Working Party, EC Members expressed the view that

“a free-trade area should be considered as having been achieved for substantially all trade when the volume of liberalized trade reached 80 per cent of total trade.”³³

The Working Party report on *EFTA* on the other hand, records the view that

“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.”³⁴

Other Working Party reports reflect the view that the exclusion of a whole sector, no matter what percentage of trade involved, is contrary to the spirit of both Art. XXIV GATT, and the GATT itself.³⁵

³¹ See BISD 20S/171 at §16.

³² See the Working Party report on *EEC*, GATT Doc. BISD 6S/100 at § 34.

³³ See GATT Doc. BISD 6S/70 at § 30.

³⁴ See GATT Doc. BISD 96/83 at § 48.

³⁵ See the Working Party report on *EEC - Agreements with Finland*, GATT Doc. BISD 29S/79 at § 12.

Nothing changed in this respect in more recent years.³⁶ The GATT Analytical Index (vol. 2) on p. 824 in footnote 162 provides an exhaustive list of Working Party reports dealing with this issue: the outcome is still the same; the term under examination has not been clearly defined in relevant GATT practice.

Very recently, Australia tabled a proposal on the clarification of the term which is at least worth discussing.³⁷ Australia parts company with the usually mentioned but hardly defined idea that the term “substantially all trade” reflects both a quantitative and a qualitative element. In Australia’s view, there is only a quantitative element that can come under “substantially all trade” and future negotiations should concentrate on putting a number next to the concept. Australia specifically proposed that “substantially all trade” should be defined as coverage by a free-trade agreement or an agreement establishing a customs union of 95% of all the six-digit tariff lines listed in the Harmonized System. In its responses to questions by other WTO Members,³⁸ Australia accepted that the 95% figure is an arbitrary figure but intended to move negotiations out of a deadlock and provide a workable and reasonable rule of thumb. Australia was also mindful of the fact that in case trade is concentrated in only few products, the 95% figure could exempt sizeable trade flows. This is why it also proposed an assessment of prospective trade flows under an arrangement at various stages.

So far however, this proposal has provoked no meaningful discussion.

³⁶ See the Working Party report on *Free Trade Area between Canada and the US*, GATT Doc. BISD 38S/73 at § 83.

³⁷ See WTO Doc. WT/REG/W/18 (17 November 1997).

³⁸ See WTO Doc. WT/REG/W/22/Add. 1 of 24 April 1998.

The CRTA as well, proceeded to discuss the meaning of the term. In a series of papers that the WTO Secretariat prepared for the Committee,³⁹ the conclusion was inescapable: 50 years of practice notwithstanding, WTO Members have failed to come up with a workable definition of the term.

(ii) Other restrictive regulations of commerce

Disagreements on the understanding of this term focus around two issues. **First**, the coverage of the term as such: starting with the 1970 Working Party report on *EEC – Association with African and Malgasy States*, one notes, on the one hand the opinion of members of the Working Party which were not members to the notified PTA to the effect that free trade within the meaning of Art. XXIV.8(b) did not exist in view of the continued imposition by certain parties to the Convention of fiscal charges on imports from other members. At the same time, the members of the PTA were declaring that

«the provisions of Article XXIV, concerning the concept of a free-trade area concerned only protective measures. The taxes referred to were of a fiscal character, not protective...».⁴⁰

Where should the line between ‘protective’ and ‘fiscal’ be drawn, was not discussed (and explained) any further. The cited passage unambiguously denotes the disagreement between the members of this Working Party as to the coverage of the term “other restrictive regulations of commerce.”

Second, the issue whether the list of provisions reflected in the parenthesis⁴¹ in Art. XXIV.8 GATT should be deemed to be of exhaustive character or not: the inferences to

³⁹ See WTO Docs. WT/REG/W/17 (31 October 1997); WT/REG/W/17/Add.1 (5 November 1997); WT/REG/W/17/Corr. 1 (15 December 1997); WT/REG/W/17/Rev. 1 (15 February 1998).

draw from the omission of Art. XXI GATT (the security exception) from the list reflected in the parenthesis was discussed in the Working Party report on the *EEC*. The view of the (then) EEC Member states was that:

“it would be difficult, however, to dispute the right of contracting parties to avail themselves of that provision which related, inter alia, to traffic in arms, fissionable materials, etc., and it must therefore be concluded that the list was not exhaustive.”⁴²

Other Working Party reports reflect a series of discussions on this issue, but no definitive agreement across countries.⁴³

Similar discussions are reported with respect to the relationship between Art. XIX GATT, and Art. XXIV GATT: what inference should one draw from the fact that the former has been omitted from the list reflected in the parenthesis? During the Uruguay round negotiations, a draft decision was tabled to clarify once and for all the relationship between the two legal provisions. It read:

“When an Article XIX action is taken by a member of a customs union or free-trade area, or by the customs union on behalf of a member, it [need not] [shall not] be applied to other members of the customs union or free-trade area. However, when taking such action it should be demonstrated that the serious injury giving rise to the invocation of Article XIX is caused by imports from non-members; any injury deriving from imports from other members of the customs union or free-trade area shall not be taken into account in justifying the Article XIX action.”⁴⁴

Had this proposal been accepted, it would have provided a much needed clarification on this score. The proposal was, alas, rejected.

⁴⁰ See BISD 18S/133 at pp. 135-137.

⁴¹ Art. XXIV.8 GATT outlaws any restrictive regulations of commerce other than those reflected in parenthesis in the body of this provision.

⁴² See BISD 6S/70 at p. 97.

⁴³ See the Analytical Index at pp. 820ff.

⁴⁴ See WTO Doc. WT/REG/W/17/Rev. 1 at p. 4.

Subsequent practice has not helped clarify this issue either: on two occasions, first the Appellate Body and then a panel subsequently dealing with the same issue, were faced with the question whether a member of a PTA (a CU in the case of Argentina⁴⁵ and an FTA in the case of the United States⁴⁶) could impose safeguards against other members of the PTA. Note that on both occasions, the WTO adjudicating bodies were requested to interpret the WTO Safeguards Agreement, and not Art. XXIV GATT *per se*. However, through their interpretation they were clearly “influencing” the question whether the items figuring in the parenthesis of Art. XXIV.8 GATT form an exhaustive list or not. On both occasions, the WTO adjudicating bodies held for the proposition that members of a PTA can impose safeguards against other members of a PTA, provided that they respect a parallelism: they can do so, if they have counted PTA-imports when assessing injury; they cannot do so, if they have not counted PTA-imports when assessing injury.

Following these events, it is clear now that the list in the parenthesis of Art. XXIV.8 GATT is not an exhaustive one. Safeguards for sure are now included.⁴⁷ What else

⁴⁵ See *Argentina – Safeguard Measures On Imports Of Footwear*, WTO Doc. WT/DS121/AB/R of 14 December 1999.

⁴⁶ See *United States – Definitive Safeguard Measures On Imports Of Wheat Gluten From The EC*, WTO Doc. WT/DS166 of 31 July 2000.

⁴⁷ The Appellate Body had the opportunity to pronounce on the legal status of GATT adopted panel reports: according to its case law, such reports form part of the so-called GATT *acquis* and provide useful guidance to subsequent panels dealing with the same issue. It had never had the opportunity so far to pronounce on the legal status of WTO adopted reports. From a political perspective GATT adopted reports seem to carry enhanced legitimacy because of the *imprimatur* given to them through positive consensus of the losing party (which is not the case in the WTO era with the passage to negative consensus). From a legal perspective however, it would seem untenable to support the thesis that WTO adopted reports do not enjoy at least the same status as their GATT counterparts. So although there is nothing like *stare decisis* in WTO law (indeed, there is nothing like *stare decisis* in public international law) adopted WTO reports exercise, as modern practice shows, considerable influence on subsequent reports dealing with the same issue. Following prior decisions when appropriate, and motivating departures when needed is probably the surest way for WTO adjudicating bodies to acquire legitimacy.

however is included? Should one by analogy be brave enough and apply the stated reasoning in all forms of 'contingent protection'? Only future experience will tell.

Finally, the treatment of rules of origin deserves special mention here, since it is a very adequate demonstration of the current mess. As already stated, there is no common interpretation regarding other restrictive regulations of commerce (Art. XXIV.8 GATT). At the same time, there is no common understanding of the term other regulations of commerce either (Art. XXIV.5 GATT). As a result, adopted reports evidence no discussion of this term from a legal perspective, although factual information on say preferential rules of origin is occasionally being provided.

(c) Disagreeing on more mundane issues is very much a GATT/WTO practice

But even when moving beyond (il)legitimate disagreements as those described above, CRTA-practice has not managed to offer any common understanding even on the most mundane issue of them all in this context: the timing of notification. The wording of Art. XXIV GATT suggests that what is notified is *prospective action*. The language stops short of mentioning that Art. XXIV GATT operates as a 'green light', necessary to comply with, for a PTA to be GATT-compatible. It could of course be legitimately argued that since what is notified is prospective action and since the consistency of prospective action is the subject-matter of multilateral review, WTO Members should refrain from *practicing* their PTAs before they are given the 'green light' to do so. The CRTA was probably intended to serve a function similar to that of an antitrust authority when examining a merger: the merger cannot be consumed absent a 'green light'.

Practice, however, has moved to the opposite direction. Most of the time, especially recently, PTAs have been notified, contrary to the wording of Art. XXIV :7(a), *ex post*

facto (after their establishment). For example, the *NAFTA* was signed on 17 December 1992, entered into force on 1 January 1994 and a Working Party to examine its consistency with the GATT rules was established only on 23 March 1994. The respective dates for the *EC –Visegrad* Agreements (free-trade areas with Hungary, Poland and the Czech and Slovak Federal Republic Interim Agreement) are 16 December 1991, 1 March 1992 and 30 April 1992.⁴⁸

All in all, on 7 PTAs that have already entered into force, no request for examination of their consistency with Art. XXIV GATT has been submitted; 38 PTAs in force still await the beginning of the factual review; 17 of them are under factual examination; finally, on five them (including *NAFTA* that entered into force over 10 years ago) consultations on the draft report are being held at the moment of writing.⁴⁹

The CRTA consequently, has been presented with a *fait accompli*: what was originally supposed to an *ex ante* review became slowly an *ex post* review with all the problems that such a shift in the timing of notification might entail.

The impossibility to react to delayed notifications has a domino effect: indeed, what, other than dissolution of the PTA, is the remedy in case a PTA in force is found to be WTO-inconsistent? Since PTAs represent an, in principle, permanent deviation from MFN, members of an illegal PTA would have to continuously compensate their trading partners for all trade diversion caused by the PTA? On the other hand, how realistic is it to see a suggestion by a WTO panel to dissolve an existing PTA? Delayed notifications, it seems, are a contributing factor towards tolerance of PTAs of doubtful WTO-consistency.

⁴⁸ There is a plethora of examples in this regard. For information on this issue, on all notified PTAs, see the Table presented in the GATT Analytical Index pp. 858ff.

4.3 Choosing between tracks: practice

Where does all this leave us? The CRTA has never gone so far as to unanimously pronounce on the incompatibility of a notified PTA with Art. XXIV GATT.⁵⁰ Hence, if at all, CRTA reports, with 5 exceptions so far, reflect a disagreement. Track II is, as established above, available. Since 1995, recourse to Track II has been greatly facilitated through the passage to negative consensus, where the will of the complainant suffices for a panel to be established (its report adopted, and countermeasures, assuming non compliance in case of victory for the complainant, authorized). One would expect that since disagreements on the consistency of a PTA with the WTO reflect disagreements about the interpretation of the key terms discussed above, and since panels are there to decide on the clarification/interpretation of the WTO contractual terms, panels would be quite busy in this area. Yet, practice evidences the contrary. Before however, we move on to discuss the possible reasons why this has been the case, let us first take an exhaustive look into panel practice in this area.

4.3.1 GATT panels: conflicting, (scarce) evidence

During the GATT years (1948-1994), three panels were established to examine claims relating to the consistency of a PTA with the multilateral rules.⁵¹ Two reports were

⁴⁹ Source: www.wto.org

⁵⁰ Schott (1989, p. 25) mentions only four unanimous decisions. In all four cases, Working Parties actually admitted that the notified PTA was GATT-consistent. The same was true in the only other case decided by consensus ever since: the Customs Union between the Czech and the Slovak Republics.

⁵¹ The first, after a request by Canada in 1974 in connection with the accession to the European Community of Denmark, Ireland and the United Kingdom (GATT Doc. C/W/250) was not activated because the parties to the dispute reached an agreement (GATT Doc. C/W/259). The second, led to an un-adopted panel report in *EC – Tariff Treatment on Imports of Citrus Products from Certain Countries in the*

issued and they both remain un-adopted. The first report from this experience is the *EC – Citrus* panel report which is arguing for an examination of individual measures only by panels and is refusing to pronounce on the overall consistency of a PTA with the multilateral rules. The panel does not see its role as a surrogate to the (then) Art. XXIV Working Parties:

“The Panel noted that at the time of the examination of the agreements entered into by the European Community with certain Mediterranean countries, there was no consensus among contracting parties as to the conformity of the agreement with Article XXIV.5...The agreements had not been disapproved, nor had they been approved. The Panel found therefore that the question of conformity of the agreements with the requirements of Article XXIV and their legal status remained open.”⁵²

This report remains un-adopted, and hence, of limited legal relevance.⁵³

The second report is the one on *EEC – Bananas*. This report made one important interpretative contribution by holding that one way preferential arrangements are *per se* inconsistent with Art. XXIV GATT; obligations to liberalize must be assumed by all participants. § 159 of the report relevantly reads in this respect:

“This lack of *any* obligation of the sixty-nine ACP countries to dismantle their trade barriers, and the acceptance of an obligation to remove trade barriers only on imports into the customs territory of the EEC, made the trade arrangements set out in the Convention substantially different from those of a free trade area, as defined in Article XXIV:8(b).”

Unsurprisingly, the same panel went on to conclude in § 164 that the *Lomé Convention*

Mediterranean Region, GATT Doc. L/5776 (hereinafter the *EC – Citrus* panel report). The third report is on *EEC – Import Regime of Bananas*, GATT Doc. DS38/R of 11 February 1994 (hereinafter the *EEC – Bananas* panel report) which also remains un-adopted.

⁵² See GATT Doc. L/5776, dated 7 February 1985 at § 4.6 and at § 4.10.

⁵³ See on this issue the conclusions of the WTO Appellate Body in *Japan – Taxes on Alcoholic Beverages*.

(the agreement between the European Community and a series of African, Caribbean, and Pacific states) did not correspond to the type of agreements which Art. XXIV GATT covers. This report as well remains un-adopted and, although the view expressed in the cited passage is sound, the legal value of the report is minimal.

4.3.2: WTO panels: potential PTA-busters

During the WTO-era, practice continues to be scarce. However, the resulted case law is far from being negligible. The *Turkey – Textiles* panel report⁵⁴ records the first time that the issue of consistency of a PTA with the GATT was discussed. India argued that it suffered damage as a result of Turkey’s decision to erect new barriers to its textiles exports, following the signature and the entry into force of the *European Community – Turkey Customs Union*. India argued that its MFN-rights were being impaired and the ball shifted to Turkey’s camp to justify its measures. Turkey invoked its CU with the European Community, and the panel had first to address whether it was competent to discuss the consistency of a PTA with the GATT. It held the view that WTO adjudicating bodies are competent to examine PTA-related issues, but should stop short from providing an overall assessment of consistency of a PTA with the WTO contract. The view of the panel on this issue is reflected in §§ 9.52 and 9.53 of the report. We quote:

“As to the second question of how far-reaching a panel’s examination should be of the regional trade agreement underlying the challenged measure, we note that the Committee on Regional Trade Agreements (CRTA) has been established, *inter alia*, to assess the GATT/WTO compatibility of regional trade agreements entered into by Members, a very complex undertaking which involves consideration by the CRTA, from the economic, legal and political perspectives of different Members, of the numerous facets of a regional trade agreement in relation to the provisions of the WTO. It appears

⁵⁴ See the panel report on *Turkey – Restrictions on imports of textile and clothing products*, WTO Doc. WT/DS34/R of 31 May 1999.

to us that the issue regarding the GATT/WTO compatibility of a customs union, as such, is generally a matter for the CRTA since, as noted above, it involves a broad multilateral assessment of any such custom union, i.e. a matter which concerns the WTO membership as a whole.

...

As to whether panels also have the jurisdiction to assess the overall WTO compatibility of a customs union, we recall that the Appellate Body stated that the terms of reference of panels must refer explicitly to the "measures" to be examined by panels. We consider that regional trade agreements may contain numerous measures, all of which could potentially be examined by panels, before, during or after the CRTA examination, if the requirements laid down in the DSU are met. However, it is arguable that a customs union (or a free-trade area) as a whole would logically not be a "measure" as such, subject to challenge under the DSU." (footnotes omitted).

In the panel's view, for reasons having to do more with the administrative burden, the CRTA is the more appropriate forum to review consistency of notified PTAs. The panel report was appealed. The Appellate Body report holds for a different proposition. The Art. XXIV GATT defense, in the Appellate body's view, holds only if two conditions are met:

"First, the party claiming the benefit of this defense must demonstrate that the measure at issue is introduced upon the formation of a customs union that fully meets the requirements of sub-paragraph 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. ... 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."⁵⁵

In the Appellate Body's view hence, WTO adjudicating bodies must request from parties raising the PTA-defense to first establish that they have fulfilled the conditions to raise such defense. To what extent the cited *obiter dictum* of the Appellate Body will be followed in future experience, remains of course to be seen.

More recently, the panel report on *United States – Definitive safeguard measures on imports of circular welded carbon quality line pipe from Korea*⁵⁶ faced an argument by the United States that, since it is a member of NAFTA, it was entitled to treat imports from NAFTA different than imports from non-NAFTA sources when imposing a tariff quota. The panel first addressed the issue of burden of proof (*burden of production*):

“As the party seeking to rely on an Article XXIV defense ... the onus is on the United States to demonstrate compliance with these conditions.” (§ 7.142 of the report).

The same report addressed the issue of the quantum of proof (*burden of persuasion*) that the party carrying the burden of proof has to provide in order to establish a prima facie case of consistency of a PTA with the multilateral rules. § 7.144 of the report reads in this respect:

“In our view, the information provided by the United States in these proceedings, the information submitted by the NAFTA parties to the Committee on Regional Trade Agreements (“CRTA”) (which the United States has incorporated into its submissions to the Panel by reference), and the absence of effective refutation by Korea, establishes a prima facie case that NAFTA is in conformity with Article XXIV:5(b) and (c), and with Article XXIV:8(b).”

The information provided by the United States in the proceedings is reflected in § 7.142 of the report and is exhausted in a statement that duties on 97% of the NAFTA-parties’ tariff lines will be eliminated within 10 years, whereas with respect to “other regulations of commerce” a reference to “the principles of national treatment, transparency, and a variety of other market access rules” is made plus the information that NAFTA participants had to submit to the CRTA. It seems that, in the panel’s view, the submitted

⁵⁵ See WTO Doc. WT/DS34/AB/R of 22 October 1999 at §§58-59.

information was enough to make a *prima facie* case of consistency of NAFTA with Art. XXIV GATT. The panel seems to have paid particular attention to the fact that the complainant did not refute the evidence provided. The panel however, did not entertain a comprehensive review of the evidence before it. This is probably disappointing. At the same time, it is the only instance (not condoned yet by the Appellate Body) where the issue of the burden of persuasion was discussed.

As to the legal significance of the fact that the CRTA had not issued its report at the time the dispute was submitted to the panel, § 7.144 reads:

“Concerning Article XXVIII:8(b), we do not consider the fact that the CRTA has not yet issued a final decision that NAFTA is in compliance with Article XXIV:8 is sufficient to rebut the *prima facie* case established by the United States. Korea’s argument is based on the premise that a regional trade arrangement is presumed inconsistent with Article XXIV until the CRTA makes a determination to the contrary. We see no basis for such a premise in the relevant provisions of the Agreements Establishing the WTO.”

5 Why stay idle?

The delegate of the EC, the absolute champion in numerical terms of PTAs, is recorded stating in the 1978 Working party report on the *Agreement between the EEC and Egypt* that

"...as regards the possibility of consultations with the contracting parties concerning the incidence of the Agreement on their trade interests ... nothing prevented these countries from invoking the relevant provisions of the General Agreement, such as Articles XXII and XXIII".⁵⁷

⁵⁶ WTO Doc. WT/DS202/R of 29 October 2001

⁵⁷ See GATT Analytical Index at p. 781

The EC delegate probably knew that subjecting the EC's numerous PTAs to meticulous scrutiny was not much of a credible threat. His expectation was probably rational, at that time at least, since in the GATT years the defendant had the right to even block the establishment of a panel. Have things changed ever since? On the one hand, there is a proliferation of PTAs. There is no reported case of an adopted report, irrespective whether it agrees or disagrees with the consistency of a PTA with Art. XXIV GATT, since 1.1.1995. On the other hand, **first**, the substantive law is now, in part, clearer (*Understanding on Art. XXIV GATT*) and, it is also clear, that panels have the competence to adjudicate claims relating to the consistency of a PTA with the multilateral rules; **second**, panels will be established at the sole request of the complainant; **third**, the original burden of proof of the complainant is easy to meet (the complainant would be required to demonstrate deviation from MFN and, upon such demonstration, the burden of proof would shift to the defendant), whereas the defendant will have to show that its PTA is GATT-consistent. To conclude, in light of a proliferation of PTAs of doubtful GATT-consistency, it seems that case law has opened a huge avenue to potential complainants aiming to challenge before the WTO-judiciary the consistency of such PTAs with the multilateral rules.

Yet, there is not much judicial activity in this respect. Except for the two cases mentioned, there is no other reported case in this context. So why have WTO Members stayed idle? Is not the problem, a real problem?⁵⁸

In what follows, I try to advance some potential avenues for future research. I lay out some possible reasons that could help explain why, in light of the discussion above, rational behaviour would support very few, if any, challenges against PTAs before WTO panels. There is no ranking among the various possible explanations. I look into

explanations depending on whether a WTO Member is an *outsider* or an *incumbent*, that is, whether it participates or not in a PTA, since the former (much narrower) and the latter (much wider) category of countries might for different reasons rationally choose not to challenge the consistency of a PTA with the multilateral rules.

5.1 The outsiders: if I don't do it, somebody else will

Take the case of a WTO Member which does not participate in any PTA. The list is of course shrinking all the time. A risk averse WTO Member would rationally choose not to challenge a PTA, even though it does not run the risk that its actions might provoke legal challenges on the same score⁵⁹, and this for a number of good reasons: the contract is highly incomplete and risk averse panels might rationally choose not to pronounce the inconsistency of a PTA, unless if they stand on very firm grounds (5.1.1); the cost of litigation should not be under-estimated (5.1.2); cost-benefit analysis might suggest inaction (5.1.3); reasons having to do with not restraining their own future behaviour might argue against a challenge (5.1.4); other policy/political reasons might point to the same perspective (5.1.5 & 5.1.6).

5.1.1 Risk averse agents (panels)

A panel is usually composed of trade delegates, career diplomats serving in Geneva.⁶⁰ When facing a question relating to the consistency of a PTA with the WTO, they know

⁵⁸ See the paper by Limao (2005) on this score.

⁵⁹ One of course cannot exclude that a legal challenge under Art. XXIV GATT, might provoke a legal challenge against the complainant under a different legal provision. Indeed there is increasing empirical evidence that action by A against B in antidumping, increases the likelihood that B might attack A in the same field. Martin and Vergote (2004) find that antidumping is being increasingly used in a strategic, retaliatory fashion. In the Martin-Vergote setting, retaliation actually occurs in equilibrium as part of a cooperative relationship among privately informed governments.

⁶⁰ On the function of panels and, more specifically, the decisive role of WTO Secretariat, see the excellent

that they are not prejudging just one transaction (as is the case for example, when they face a challenge against an allegedly illegal imposition of antidumping duties). Through their response, they will be putting into question all subsequent trade-related behaviour of the PTA-hopefuls. They also know that

- (a) no WTO adjudicating body before them ever moved to pronounce on the inconsistency of a PTA with the WTO, unless in very obvious cases (such as the EC/ACP arrangement quoted above); that
- (b) they have little legislative guidance to draw from, since the terms of Art. XXIV GATT, with the few notable exceptions mentioned *supra*, have not been further elaborated/interpreted either through legislative activity or through subsequent (CRTA) practice; and that
- (c) probably there is a relation between (a) and (b), that is, *wisely* previous panels chose to abstain from far-reaching pronouncements in the absence of a clear legislative document.

They are also aware that PTAs are being tolerated in the WTO. As Schott (1989, p.25) mentions:

“Besides the ambiguity of its provisions, political considerations have often outweighed other factors in decisions to accede to the terms of the agreements. In addition, affected third countries have been reticent to criticize preferential deals because the majority of GATT members participate in such agreements”.

analysis in Nordström (2005a) which supports the conclusions reached here (the WTO Secretariat, aware of the extent of unresolved issues before the CRTA would hardly be pressing for definitive interpretations in the context of Art. XXIV GATT).

To a large extent, WTO Members have learned to live in a world where PTAs will not be challenged and, by now, they might rationally be expecting to receive a no challenge – status when they enter into PTAs.

Unless if they are on firm grounds, panels might rationally choose to abstain from making a definitive pronouncement on the question asked. In light of the uncertainty surrounding the precise legal frontiers between consistency and inconsistency with the multilateral rules, except for exceptional cases, it is unlikely that a panel will find itself on firm legal grounds to provide a definitive statement on the law itself. They do not have behind a *non liquet* to do that; they can find the words to pass the message that for example, the burden of proof has not been met, or evidence provided has not been effectively refuted and ask additional homework from the complainant.

5.1.2 Cost of litigation

The cost of WTO-litigation should not be under-estimated. Bown and Hoekman (2005) provide some numbers and point to the fact that the numbers they cite in and of themselves might dissuade potential complainants from launching complaints. Nordström (2005b) concludes along the same lines and his empirical study cautions against those who tend to under-estimate the cost of a WTO litigation. Of course, a potential complainant will measure the cost of litigation against the probability to prevail and the expected profits in case it does prevail. As already stated above, the original burden of proof for a complainant in such a case is quite low. However, the burden of proof might shift back to the complainant, in case panels adopt an attitude similar to that of the panel report on *United States – Definitive safeguard measures on imports of circular welded carbon quality line pipe from Korea* discussed above. In such a case, the complainant will have to address technical arguments in an area of law that is far

from yielding predictable outcomes in case of litigation. More (and more technical) issues equal higher litigation costs. Remember, there has been not one single panel that so far has taken one positive step towards interpreting the controversial terms appearing in the body of Art. XXIV GATT and highlighted *supra*. Yes, the original burden of proof seems to be quite low, but no, this is not the end of the story.

On the other hand, the potential complainant will actually, through such a complaint, be subsidizing all other WTO Members. It is highly likely that a collective action problem exists here where everybody expects someone else to take the lead and free-riding is very much on the cards. Past experience eminently supports the conclusion that in this area GATT/WTO practice is akin to 'if I don't do it, somebody else will'-mentality.

5.1.3 Is it really a problem? Less enforcement, better (export) opportunities

It is maybe counter-intuitive why WTO Members would be willing to enforce the internal requirement: the less trade liberalization exists among constituents of a PTA, the less trade diversion will take place. Assuming that trade diversion goes against the interests of a particular exporter (who will thus be losing a market), the less members of a PTA liberalize their trade in cars, the better export opportunities outsiders will have to export cars to the PTA at hand. Of course, the opposite could be the case as well. An example with complementary products would be most appropriate to illustrate this: the more members of a PTA liberalize trade in cars, the likelier it would be for WTO Members non-parties to the PTA to sell wheels in the PTA-market. This example serves the purpose to show that challenging a PTA is not necessarily the best way to receive compensation for trade diversion. Staying idle might work as well.

At best, the argument why non-parties would be willing to enforce the internal requirement is less clear than with respect to the external requirement.

5.1.4 Why narrow down future options?

Outsiders of today might be incumbents of tomorrow. Successfully arguing a PTA-related case might come at a cost, since, in case today's successful complainant might decide to go 'preferential' tomorrow, it might be facing the music it helped, through its pleadings, compose. A nonchalant understanding of the existing regime (Art. XXIV GATT) on the other hand, might come handy assuming a change of heart on this issue.

5.1.5 Side payments

One cannot *a priori* exclude that inaction might reflect a side payment for favours by members of a PTA in other fields of government activity. There is some off the record (hard to prove) evidence to this effect.

5.1.6 Too much at stake?

Take the case of the European Union. Today's level of integration is a far cry from the picture in the late fifties. GATT contracting parties however, chose (rationally) not to challenge the European integration process at the time. Indeed, there was too much at stake: destabilizing the process through a legal challenge before the GATT could have had impossible to measure side-effects. Who in the GATT would be eager to take the credit for successfully outlawing a GATT-inconsistent CU, knowing that, at the same time, it would be also taking the blame for destabilizing a quintessential piece of the

post-World War II peace process? I am not suggesting that all PTAs around reflect the very same specificities of the European integration process. But it is entirely plausible that the elements of the decision to going preferential could well extend beyond trade concerns. Knowledge of such elements, or indeed, even uncertainty about them, might prove enough for a deterrent against a legal challenge.

5.2 The incumbents: I won't do it, you shouldn't either (no room for eye for an eye)

The data discussed above (112 CUs and FTAs) and the identity of players participating in the preferential game supports the intuition that probably we are facing a mutual deterrence-scenario. Nowadays, all important players participate in one or more PTAs. Most of them are of dubious WTO-consistency. They probably naturally moved to a cooperative equilibrium where no one challenges no one else's PTA and live happily within a regime of tolerance. Deviating from the current situation could open up a big number of legal challenges that probably no one wishes to face at this stage.

At the same time, in light of the legal uncertainty as to what is a WTO-consistent PTA, even those who might believe they have complied with the legislative requirements when entering into a PTA, assuming such a group exists, if sufficiently risk averse, could be unwilling to mount the first challenge for fear of reciprocal activity against them. The results by Martin – Vergotte (2004) are probably relevant here: an incumbent challenging a PTA, if successful, is probably *ipso facto* shooting itself on the foot. Any interpretation / clarification of the requirements reflected in Art. XXIV GATT in a given case, assuming that the case law aspect of such a pronouncement will not be neglected in future litigation, risks facing the achieved interpretation in challenges against its own PTA. Any interpretation in other words, could become the benchmark to (re-) discuss the consistency of its own PTA with the multilateral rules. In such cases, there is probably *ex*

ante substantial uncertainty as to the content of the interpretation; there is however, quasi certainty that, whatever the interpretation might be, it will, eventually, be applicable against the original complainant's PTA. Consequently, the complainant will have to choose between a strategy of passivity, where its own PTA is not being challenged either, and a strategy of active behaviour, where it risks paying the price for any ephemeral victory before a WTO adjudicating body. It will rationally choose the latter, only if it knows that market access gains from the former outweigh any policy options associated with the latter option.

5.3 Is there a third group of countries?

In what precedes, I have not discussed at all the attitude of WTO Members participating in a WTO-consistent PTA. But what is a WTO-consistent PTA? Assume PTAs that have been cleared through the CRTA process are WTO-consistent. This is a necessary but not a sufficient condition for us to think of a third group of countries. It could very well be the case that WTO Members participate in both WTO-consistent PTAs and PTAs of, at best, uncertain WTO-consistency. This is, for example, the case of the Czech and the Slovak republics which have had a WTO-consistent CU between them, but now, through their accession to the European Union, find themselves participating in dozens of PTAs of dubious WTO-consistency.

6 MFN is LFN

Bhagwati, in his inimitable manner, often likes to refer to MFN as the LFN, the least favoured treatment: the number of exceptions to MFN, have substantially reduced its current importance in trade matters. PTAs are but one of the numerous exceptions.

The existing framework does not look very promising, assuming there is agreement that something needs to be done: WTO Members would probably need to reflect on a new, more workable test to discuss the consistency of PTAs with the multilateral rules, otherwise they risk seeing no change in the current practice. On the other hand, changing the rules of the game requires some additional thinking on the alternatives to the current loose PTA-review. Through PTAs, countries integrate in other, not necessarily WTO-covered areas. Trade could simply be a component of a wider scheme and one needs to measure the impact of introducing PTA-busters in the WTO regime. In a nutshell, yes there is a problem through the current inaction, but we might be creating another type of problems by introducing active surveillance. It seems to me that all the pieces of the puzzle have not yet been put in place.

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