Regional Trade Agreements in the GATT/WTO: Article XXIV and the Internal Trade Requirement
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Introduction

This book is about one of the oldest "trade and..." problems, that being the issue of trade and discrimination. From the perspective of the multilateral trading system, one asks generally how discrimination against goods on the basis of their origin may remain an effective strategy in the WTO? Or, as more simply expressed, what are the remaining "loopholes" in the WTO? The present study is identified as a sub-genus of the topic as it is located in the context of trade discrimination as employed between members of regional trade agreements.

An introductory explanation of the term "discrimination" as used here would be helpful. In trade law, the term "preference" is nearly, if not precisely, synonymous with that of discrimination. The literature on regional trade agreements, or regionalism, is primarily dedicated to exploring, in theory or practice, the (diversionary) effects of preferential (discriminatory) trade agreements. The question is well oriented to considering the resulting situation for non-members. It is an economic question in large part, and is often expressed in the economic parlance of trade creation or diversion, even when one may be seeking to address a political or legal aspect of the problem. The common starting point is that regional preferences resulting in overall (global) trade creation should be encouraged, or at least tolerated, as compatible with the trading system. Preferences resulting in trade diversion should be considered otherwise.

That this economic formulation has had influence on the concept of legal compatibility can almost be taken on notice. Certainly, much of the discussion of the legal question has tended to follow the economic rubric, suggesting accordingly that GATT rules should permit trade-creating regional arrangements and should disqualify those resulting in diversion of trade.

In point, if there were any theme common to the following chapters, it would be the intent to dispel this notion as legal criteria. In order to validate this view, the possibility of both positive and negative preferences within a regional setting should be considered. This consideration undermines the question as expressed above, for if one only characterises the regionalism issue in terms of trade creation or diversion, there remains a strong presumption that only positive preferences are exchanged between regional members. That this formulation is incomplete is validated by Jacob Viner's own analysis of the problem. He understood that given the freedom to select preferences, that regional members could select both those intended to divert external trade as well as ignoring those that actually created regional competitive forces. An additional challenge to the traditional formulation of the regionalism issue is found in trade law and policy generally. Examples include the selectivity of contingent trade instruments such as Anti-dumping and countervailing duties, those permitting

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1. Webster's Seventh Collegiate Dictionary defines preference as, "the act, fact, or principle of giving advantages to some over others."
3. The terminology of positive and negative preference is drawn from Snape, Richard H., Discrimination, Regionalism, and GATT (cite not attributable), but see also Snape, Richard H., History and Economics of GATT's Article XXIV, in K. Anderson and R. Blackhurst, (eds), Regional Integration and the Global Trading System, Harvester Wheatsheaf, 1993., pp. 273-291, at p. 276, regarding the use (or non-use) of MFN clauses within regional agreements. See also, Roessler, Frieder, The Relationship Between Regional Integration Agreements and the Multilateral Trade Order, in K. Anderson and R. Blackhurst, Ibid., pp. 311-326. Roessler poses the possibility directly at p. 318: "(A) zero-tariff commitment incorporated in a regional agreement leaving broad scope for the unilateral imposition of other import controls, or providing for no effective dispute settlement procedures, may therefore generate less trade than a tariff binding at a moderate level under the GATT."
emergency action for safeguards or balance of payments, and remedies against other "unfair" public and private practices affecting trade.\(^4\) For all, there can always be a question whether the negative discrimination being exercised is lawful according to the GATT rules, including most-favoured nation treatment. Outside the regional context, the frequency and legality of negative discrimination is clearly a preoccupation of WTO Members.

However, in examining the applicability of GATT rules to regional systems, the underlying assumption seems rather that all preferences exchanged by regional members are positive. In those rare cases where a party has suggested that negative preference between regional members may be a feature of some regional scheme, some certain confusion has then appeared to result. This includes suggestions that that GATT rules are entirely unclear as to whether negative preferences are permissible between members, or more expansively, that regional systems and their members are immune from the operation of GATT and WTO rules due to the operation of Article XXIV.

One motive for taking the topic along these lines flowed from the author's attempts to reconcile certain lecture points. In noting Viner's contribution that not all customs unions were per se positive for world welfare, and in reviewing GATT Article XXIV requirements for customs unions, it became apparent over time that a "fit" between economic objectives and the GATT rules should not be taken for granted. From there, it was not difficult to locate the classic legal literature on Article XXIV, notably Dam's 1963 Chicago Law Review article on the Legacy of a Misconception. According to him, to the extent that Article XXIV paragraph 8 requirements mandated a high degree of preferential exchange between members, this could result in more trade-diversionary agreements being sanctioned under the GATT rules. Article XXIV drafters conducted their tasks prior to Viner and appeared to misconceive the precept that not all completed customs unions (or free-trade areas) would result in trade-creation for the world as a whole. Dam's material confirmed the starting point of the literature suggesting a functional amendment of the GATT rules to accommodate Viner's discovery. The solution suggested by Dam, and other since, was to "creatively re-interpret" the Article's paragraph 4 requirements (not to raise new barriers) so that resulting agreements would not divert external trade.

This insight squared the lecture points, but it raised more questions. If economists were correct that completed regional arrangements could divert more trade than incomplete arrangements, then what conclusion should be drawn for so many incomplete regional agreements that had been formed through the GATT years? Through the failure of GATT Parties to enunciate and apply Article XXIV's paragraph 8 criteria, were the resulting arrangements rendered more trade-creating as a result of these limited exchanges? At least anecdotally this did not seem to be case. Rather, it appeared that much of the trade left "uncovered" between regional members was the same trade that should contribute to regional trade creation if it were also liberalised. Further, the instruments permitting such trade between members to remain uncovered did not seem to relate to most-favoured nation treatment. Rather than referring to MFN duties for such trade, regional agreements could be found which placed trade on quantitative restrictions, tariff quotas, surveillance and licensing, specialised safeguard regimes, and a host of other possibilities. Even the inherent necessity of preferential rules of origin suggested that trade between free-trade area members could be a raising of barriers to internal trade where a severe criterion is adopted.

While regional parties clearly had the capacity through the GATT years to eliminate certain trade flows from their arrangements, it was also apparent, although not empirically, that some of these omissions likely reflected relative negotiation power between the members.\(^5\) Moreover, although the


\(^5\) This was suggested by some of the "hub and spoke" literature which documented that even while larger areas were being intended, that the establishment of such areas proceeded according to sequential bilateral
requirements for regional formations were being attempted to be expressed by working group delegates, it also seemed that some of the greater difficulties were being encountered in large/small and developed/developing arrangements. Thus, while the economic theory continued to refine its criticism of the irrationality of Article XXIV:8 requirements, the actual lack of stricter application of the requirements over time could not lead to a conclusion that many regional agreements, incomplete as they were regarding their own internal trade coverage, had perhaps created very much trade after all.

These considerations suggested a possible thesis. While Viner and Dam may have been correct that Article XXIV requirements were economically irrational, perhaps the intent of the drafters, in establishing the scope of application of most-favoured nation by the regional exception provisions of Article XXIV, was not to provide for only an economic result. Perhaps the objective was considerably more legal at the outset in attempting to affect the course of international economic diplomacy by the obligations contained in the GATT. From GATT’s 1947 preamble, perhaps the purpose of Article XXIV in relation to Article I was not only to provide for the expansion of world trade, but to do so according to the overriding context of eliminating discrimination in international commerce. Perhaps this stated objective in the preamble also deserved attention without regard to whether economic objectives were being met in its fulfilment.

This led to a more precise expression, that in spite of the economic irrationality of Article XXIV requirements, the alternative to requiring regional members to exchange a nearly complete set of preferences might be even worse. Therefore, the question was raised: is MFN (and perhaps other GATT rules) suspended by the operation of Article XXIV only as to non-members in regard to positive preferences exchanged between members? To ask the reverse, to what extent do GATT rules apply to the trade of members to a regional trade agreement?

The early inquiry focused on the nature of preferences in the pre-GATT era and the relationship between negative discrimination in commerce and the impending resuscitation of the MFN principle. If it were found that the advocates of the multilateral most-favoured nation clause were cognisant of the dangers of both positive and negative discrimination within preferential systems, then perhaps the drafters also contemplated some prospects along these lines. This would justify a high and mutual exchange of preferences between members regardless of certain external economic effects. However, this historical strand, while present, was not easily distilled from the larger history. The requirements could clearly be attributable to giving MFN a broad field of application to address partially preferential systems, but not specifically in regard to protecting regional members from other regional members. Paragraph 8 requirements can be understood to reduce internal discrimination and at the same time reduce the incidence of regional systems overall. Thus, both internal and external purposes could be being served by the substantially-all trade requirement. What was gleaned overall was that preferences within partial regional systems were a central problem in international trade, but more emphasised from the viewpoint of excluded parties, like the United States as to the Imperial Preference. This celebrated debate resulted in the GATT Article I compromise for the standstill of certain preferential systems. Nevertheless, the period immediately prior to the Geneva negotiations in 1947 were also witness to commentators who were critical of preference for its effects on smaller and weaker regional territories. Thus, one was left with the impression that nothing in GATT’s pre-history excluded outright the possibility that the resulting agreement might have application to the continuing trade relations between future regional members.

The future use of preferential systems was of clear concern for the developing countries going on record during the Havana negotiations in 1948. For them, the negotiated standstill at Geneva was an unfairness, as they had not yet had opportunity to establish their own regional systems and so could not avail themselves of the standstill provisions found in the MFN Article. The customs union negotiations and resulting agreements.
exception was claimed impractical for them given its administrative complexities; and the specialised development exceptions accorded in the Havana draft required a voting endorsement, as in the manner of a waiver. The introduction of a free-trade area exception to accompany the customs union provision was most likely the result of these concerns. However, this insight also did not illuminate the question of MFN control over intra-regional trade, as the context for the new free-trade area exception also appeared to be nearly wholly developmental in nature. This would merely provide an avenue for developing countries to establish larger regional markets in order to obtain the possibilities of more competitive scales of production, albeit by more comprehensive exchanges of preferences than those likely considered in pre-member complaints.

It was not until the GATT practice emerged that there was an apparent appreciation of the possibilities of flexibility offered by the free-trade area exception as between developed and developing countries. Starting with the Overseas Association review in 1958, working party members commenced the process of attempting to determine what “substantially all trade” should require. This and later reviews revealed a pattern that the issue of trade coverage was most intractable in agreements between developed and developing countries. Many commentators and review parties saw the condition of mutuality, as suggested in the substantially-all trade requirement, as mandating the re-establishment of colonial structures. The EC legal argument on the point was consistent with this view, that Part IV of the GATT could also be “read in” to the list of articles permitted as exceptions to the trade coverage requirements of paragraph 8 of Article XXIV. However, while the issue was often focused upon the “right” or necessity of developing countries to re-impose trade measures as to their more developed partner, not so much attention was paid to whether the EC was also reserving options of contingency in regard to its own trade opening commitments. This and later reviews indicated that flexibility, in the form of free-trade areas, was being sought by developed and developing members. Although the coverage requirements for both customs unions and free-trade areas were identical in the coverage provisions, the latter form emerged to provide the national instruments necessary for imposing trade measures upon another regional member.

For both the GATT-1947 and the WTO practice, there is an attempt made here to contrast the developments occurring in the process of dispute resolution to the positions maintained by the regional proponents in the working group reviews. While evolutionary, panels, and now the Appellate Body, have tended to reject the view that Article XXIV has granted regional members a right to establish self-autonomous regimes outside the framework of the GATT. However, the context for raising this central question has also developed over time. In GATT-1947, the right of a panel to even commence an inquiry as to the characteristics of a particular regional agreement was firmly opposed by regional respondents. They argued that mere notification of the existence of a regional agreement to the proper GATT authorities acted to secure the most-favoured nation exception outright, in the absence of a negative or amending recommendation from the Council. Although unreported, the impact of Bananas I and II (1993 and 1994) had certain legal reverberations in establishing that a panel could not avoid at least some prima facie examination of a regional agreement when a member had chosen to invoke it as a defence to a GATT Article violation. This suggested that Article XXIV agreements remained subject to GATT rules in some manner, and that the mere notification of an agreement and invocation of the Article would not be sufficient to avoid dispute challenges for particular Article violations, at least as to non-member complainants.

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6 As so much of the history of GATT regionalism concerns the EC's arrangements with other territories, one could be led to conclude that the study here is a one-sided critique of the EC regional policy. It is, however, a point of fact that the EC and its regional partners set the precedents for free-trade areas according to Article XXIV, and it is unavoidable that any review of the era would be mainly concerned with EC regional agreements. However, as the United States has become regionally active since the late 1980s, the analysis undertaken in the book is intended to inform this country's regional perspective as well.
To date, the WTO Appellate Body has reversed dispute settlement panels in two cases raised concerning Article XXIV. The reversals on certain points appear to affirm the trend from GATT-1947 favouring the imposition of legal criteria for the qualification of regional agreements. Thus, the first AB case rejected the panel’s attempts to reconcile the provisions of paragraph 4 and 8 of the Article. Paragraph 4 was found by the AB to be “purposeful” but not expressing a legal obligation. This holding may suggest that paragraph 8 requirements, even though unsettled, do express criteria which must be met according to the provisions, and not through the lens of economic effects such as trade diversion. The second panel found expressly that intra-regional safeguards were permitted according to paragraph 8, although Article XIX was not listed as an article exception. This view was rejected by the Appellate Body (but without ruling the opposite, i.e., that the listing of Articles was exhaustive). Both AB reports established the notion of Article XXIV as a conditional exception. Parties asserting its defence must affirmatively demonstrate that the conditions of the Article’s provisions in paragraphs 5 and 8 have been met, and that a measure violating a GATT article must be shown as necessary between members in order to excuse the violation. Thus, there appears to have been a clear rejection of any so-called “autonomous regime” theory for regional trade agreements under WTO law.

The question remains whether such an interpretation might also apply in some measure to the trade between regional members. For this question, the WTO is an international organisation and its Dispute Settlement Understanding accords reference to the interpretation of its provisions according to the generally applied rules of international law. No provision appears to have a more significant bearing on the question than that found in the Vienna Convention on the Law of Treaties (VCLT), Article 41, providing for modification between two or more members to a multilateral treaty. Thus, for the WTO and its annexed agreements, the issue of negative preferences employed between regional members now appears to be framed within the boundaries of the VCLT provision regarding the conditions by which bilateral modifications may be permissible or not prohibited. The argument developed here is that GATT Article XXIV is itself a negotiated and permissive expression for bilateral modification in the form of regional preferential trading systems. The terms of this Article require a certain degree of positive preference to be exchanged according to certain conditions. To the extent that the Article does not prescribe negative preferences between members, one may conclude that negative preferences between members are not permitted modifications. Due to the disjunctive structure of Article 41 VCLT, this interpretation may control even where a regional proponent can argue that its modification does not otherwise affect the WTO rights of non-members to the regional agreement.

We conclude by noting that a broader view of non-discrimination is advocated throughout the text, and that this wider scope of application of GATT rules has certain implications. On the level of practice, a burden shifting akin to the “reverse-consensus” concept could be seen to result de facto. Regional proponents failing to secure a recommendation for the compatibility of their arrangements appear to incur a higher risk in the process of dispute settlement. This may facilitate the establishment of meaningful criteria for paragraph 8, as there has been previous little advantage to be obtained in failing to determine criteria. A result over time could be that there would be fewer regional agreements formed, but those formed may be more complete preferential expressions. This should

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8 Overall, one understands that the issue of negative discrimination between regional members must centre on the interpretation to be given to GATT Article XXIV:8, and in respect to the internal trade requirements of subparagraphs (a)(i) for customs unions and (b) for free-trade areas. The two provisions found in both subparagraphs that relate directly to the problem, are the substantially-all trade requirement for the elimination of duties and other restrictive regulations of commerce, and the listing of GATT articles permitted to be applied as exceptions between regional members.
have implications for multilateralism more generally. If GATT’s non-discrimination objective includes the avoidance of a multi-polar trading system comprised of leading territories and their respective spheres of regional influence, a higher bar to regional formations must also be evaluated in light of such a goal.

Although this study is not intended to treat constitutional aspects, such considerations may also be considered. If the WTO evolved to be capable of applying its rules to the conduct of regional members, then some deeper source of legitimacy could also attach to the principle of most-favoured nation. Non-discrimination in the WTO context is recognised as the fundamental principle underlying the multilateral trading system. As such, the role and purpose attributed for it also tends to define the purpose of the WTO itself. Thus, if MFN’s sole function is viewed to facilitate trade expansion as a “market-access” instrument, then it perhaps deserves to succumb to a host of other “trade and....” considerations that are directly raised by the process of global economic integration. In this narrow view of MFN, the WTO itself is set into opposition with these other global objectives. On the other hand, if the principle is recognised for its purpose to eliminate discrimination in international trade, then there is also the possibility that a somewhat deeper notion of legitimacy for WTO and its rules may emerge.