Regional Trade Agreements in the GATT/WTO: Article XXIV and the Internal Trade Requirement
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2 Proposals for a Regional Exception: Geneva and Havana

2.1 Introduction

This chapter relates the origins of the GATT principle of most-favoured nation to the exceptions provided for free-trade areas, as found in GATT Article XXIV. The chapter is not intended to be a discussion of all of the legal elements presented in the Article. It will rather be limited to aspects that would serve to disclose the intent of the drafters in including the free-trade area exception, and in its relation to the MFN clause.

Complete regional formations in the form of customs unions territories had long received exemption from the MFN principle in bilateral arrangements. This treaty practice was carried forward before Geneva and was retained through the Havana Conference and the final ITO Charter. Partially preferential systems, whether Imperial/colonial structures or otherwise, were sought to be challenged by the emerging MFN principle. We will see that Havana parties also sought to retain certain prerogatives for future preferential agreements between developing countries. This was a significant commercial policy issue in Havana that likely gave rise to the provisions for free-trade areas in order to complement the provisions that were also being settled for economic development and reconstruction preferences. Thus, the debate over which preference systems would be permitted to continue after MFN came into force, and which new systems would be permitted to be established, was essentially a negotiation over the scope of application of the MFN provision itself. The result in Havana displayed a hierarchy for Members to engage in future preferences, with differing levels of organisational oversight to be exercised, depending upon the degree of preferences exchanged and the purposes for which they were to be enacted. The chapter concludes with an overview of the Article XXIV provisions as incorporated in the GATT.

2.1.1 Relating inter-war categories to the Geneva provisions

Neither Whidden nor Viner referred to any system under the terminology of a "free-trade area", and one is left to determine which systems described by them, if any, might have been contemplated by later drafters in providing a GATT MFN exception for free-trade areas. To this, the viewpoint of each author should be taken into account. Whidden’s purpose was to outline the pre-existing arrangements and then to argue that most of them should not be granted an MFN exemption. Viner’s purpose was to build an economic argument that customs unions were not per se positive for world welfare as a whole and therefore should not receive a de facto MFN exception on economic criteria alone. As such, he did not pass any explicit judgement on the qualifications of lower-order systems as to the emerging requirements. However, he did maintain an overall conclusion that the draft Havana Charter had accorded too many exceptions from MFN for regional agreements on too many counts. He accepted as only partially valid the claim that the Charter would have serious impact on the future course of preferential systems.1

Whidden's more strict conclusions were similar to what was later identified as the U.S. State department proposals for exceptions to MFN in the Geneva negotiations as,

1 Viner, Jacob, The Customs Union Issue, Carnegie Endowment, 1950, p. 120. He referred to MFN exceptions for partial customs unions (absent a requirement for revenue allocations and treatment of non-origin products), free trade areas, and regional agreements in the interest of economic development, as per Article 15 of the Charter, titled "Preferential Agreements for Economic Development and Reconstruction." In the absence of this Article, the regional possibilities would include only customs unions, free-trade areas, interim agreements leading to them, and the 2/3 waiver provisions of the General Agreement,
"It seems clear that the principle of equality of treatment would involve the elimination of trade preferences between neighbouring countries where they do not automatically lead to complete customs unions."²

While Whidden contemplated a possible role for preferential systems in a post-war Western European Union, he favoured only complete customs union formations, which he described as advancing a more sound economic justification. In this, Whidden anticipated the economic objections to any completed preference system in addressing a London Economist editorial of March of 1944. This claimed that damage to outsiders was higher in a customs union than in a regional arrangement, since "discrimination against outsiders reaches its limit in the former". From Whidden's view, a customs union was seen to benefit outsiders in regard to its increasing purchasing power obtained through more efficient production.³ While one would say that Viner's work, which appeared later in time, was intended to dispel this opinion, it does not follow in any respect that Viner was arguing for a broader MFN exception to be applied for partial regional preferences.

2.2 Arrangements and discussions in Havana

The U.S. and British proposals for the most-favoured nation clause followed the lines of agreement that had been settled between them in preparation for the UN Conference on Trade and Employment (1946).⁴ This compromise provided for a standstill for listed annexed preferences, including the Commonwealth preferences, as provided and finally incorporated into GATT Article I:2.⁵ All future preferences within the annexed systems would be subject to MFN. In addition, the U.S. submitted draft proposals for what would later become GATT Article XXIV. These clauses followed the pattern established according to its own bilateral MFN agreements formed according to the U.S. Reciprocal Trade Agreements Act. As such, the U.S. opening position recognised a granted exception from MFN for customs union territory formations.⁶

Both Kenneth Dam and John Jackson stated that a primary goal which the United States sought to accomplish in the ITO Charter and the GATT was the dismantling of trading preferences and

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² Whidden, H.P., Preferences and Discriminations in International Trade, Committee on International Policy, Carnegie Endowment for International Peace, New York, 1945, pp. 5-30, reprinted in the Economics of Diplomacy, ed. A.J. Kress, Georgetown University, Washington, 1949, at p.18; and citing, Haberler, G., The Political Economy of Regional or Continental Blocks*(ed. Seymour E. Harris), McGraw Hill, New York, 1943. He thereby proposed that, aside from customs unions, that an international commercial policy organisation would apply the following minimum criteria where necessary to permit preferential arrangements on a temporary basis and in exceptional cases:

- to be effected by duty reductions and not by increases in duties to outsiders;
- that margins of preference not to be bound (no prejudice to reduction of duties to outsiders;
- that preferences be confined to important supply commodities;
- that preferences be designed to achieve more efficient production and better balanced economies.

³ H.P. Whidden, ibid., p. 18. A point challenged by Viner. An open membership concept for preferential systems, such as contained in the Montevideo agreement, was also not considered by Whidden as possibly consistent with MFN. Later U.S. negotiating proposals did not include an exception for open reciprocity arrangements.


preferential systems, particularly the Commonwealth system established by the 1932 Ottawa arrangement. Viner suggested that the American goals were multiple: to obtain rehabilitation of the MFN principle, to promote the reduction of tariffs, to eliminate intra-imperial preferences via a multilateral framework, and to renounce official trade barriers other than duties. He suggested that these goals were well reflected in the initial drafts. While certain existing preferences were listed and acknowledged as permitted exceptions to the general MFN rule of Article I of the GATT, the original Geneva Final Act did not acknowledge the possible exception from MFN for any regional arrangements other than those to facilitate frontier traffic or for customs unions. As according to Dam, the U.S. proposals constituted only a short paragraph permitting a customs union exception. Jackson likely caught the appropriate flavour of the exception overall as intended by the U.S. drafters. As he put it, "...even the United States recognized the legitimacy of an exception for customs unions."  

A significant exception to this viewpoint at this point in time in the drafting would have been the paragraph included in the London Draft Charter (1946), providing for a 2/3 majority vote, whereby, "(T)he members recognize that there may in exceptional circumstances be justification for new preferential arrangements requiring an exception to the provisions of (the chapter dealing with customs unions)". According to Viner, as the Geneva Draft (1947) introduced the concept of interim agreements leading to customs unions, a sufficient degree of flexibility was obtained by those added provisions (presumably), and the paragraph as quoted was dropped from the customs union chapter. It did however later emerge in a modified and far more comprehensive form in a new Havana Charter chapter dealing with "Economic Development". This chapter Article should also be considered for any light it can shed on developments in the customs union chapter, especially for its later provisions regarding free-trade areas. The Development Article also permitted preferences and was a subject of debate in regard to the overall compromise formed regarding the role of future preferences and the MFN obligation.

2.2.1 Havana Charter, Chapter III, Article 15: Economic Development and Reconstruction

The proposal for the Geneva Draft (1947) was the first to provide a chapter on Economic Development. This retained the requirement of a majority 2/3 vote for approval of,

"preferential arrangements between two or more countries, not contemplating a customs union, in the interest of the programmes of economic development or reconstruction of one or more such countries."

This Article was expanded in the Havana Draft, Article 15, titled " Preferential Agreements for Economic Development and Reconstruction". While retaining the concept of pre-approval by a 2/3’s voting procedure as above, a new section was added that provided the possibility for self-declaratory preference. This was to be available to contiguous territories or those belonging to the same "economic region"; and as necessary,

8 J. Viner, Supra note 1 at p. 110.
9 K. Dam, Supra note 6 at p. 274.
10 J. Jackson, Supra note 7 at p. 577, italics added.
11 J. Viner, Supra note 1 at 115, his note 21.
12 J. Viner, Ibid., at p. 116. Free-trade areas were not yet introduced to the customs union chapter until the later Havana Draft. Thus, the paragraph quoted refers only to customs unions.
13 "The Members recognize that special circumstances, including the need for economic development or reconstruction, may justify new preferential agreements between two or more countries in the interest of the programmes of economic development or reconstruction of one or more of them." Proposed redraft, Article 15:1, E/CONF.2/C.8/26, 17 March 1948. According to the interpretive note, "The Organization need not interpret the term "economic region" to require close geographical proximity if it is satisfied that a sufficient degree of economic integration exists between the countries concerned." Ibid., Ad Article 15.
"to ensure a sound and adequate market for a particular industry or branch of agriculture which is being, or is to be, created or reconstructed or substantially developed or substantially modernized."\textsuperscript{14}

Neither reciprocity nor reduction to zero-duty levels was required. However, a provision was made for the adherence of other members that would also be able to qualify as parties to the preference agreement and the preferences permitted were not intended to exceed ten years. Article 15 did not specify that the parties to such preferences were required to be least or lesser developed countries, although the conditions of the preference activities permitted can be said to resemble an infant industry type of justification and the title of the Article refers to development. Although the two-thirds voting provisions did not apply, organisational control was not abandoned for the contiguous-party exception in Article 15:4, as the exception continued to be subject to the provisions of paragraphs 5 and 6 of the Article. Paragraph 5 indicated that the Organisation may, "as a condition of its approval, require a reduction in an unbound most-favoured-nation rate of duty proposed by the Member in respect of any product so covered, if in the light of the representations of any affected Member it considers that rate excessive."\textsuperscript{15}

2.2.2 \textit{Havana's resulting hierarchy of preferences}

The apparent intended effect of the self-declaratory provisions of the Article was to permit an industry or agriculture sector to be expanded between contiguous parties or economically integrated parties, assumedly in order to provide for an expanded market within some larger regional context. It does not appear that this portion of the Article contemplated granting authority for preferential systems in the larger sense of regional integration, but rather to accommodate the special items for a limited period of time as beneficial between developing countries, or at least economically or geographically related parties. Thus, Article 15 would not be seen as an overlapping provision with the later free-trade area exception, at least where the latter would contemplate a more complete and permanent system of exchanges by the parties.

What is also observed is that both sections dealt with preferences and both were intended to become provisions of the Charter in its final form. One should therefore consider that the provisions of the two Articles were intended to be complementary in that they would not overlap in coverage but would be used to address distinct situations. Therefore, it may be concluded that Article 15 was viewed as a means of providing limited preferences between developing countries while the inclusion of a free-trade area exception was intended to service the notion of more complete regional entities. As developed in some detail below, an important distinction between the two Articles as they emerged from Havana, was that Article 15 retained the requirement of a waiver from MFN to be approved by a 2/3 vote of the Charter Members, except for these contiguous sector preferences as noted. For regional groupings meeting the substantially-all trade definition in the customs union chapter, a less rigorous approval process was established, but with the consideration that a consensus of the Members could always impose modifications upon an agreement. Thus, there appeared to emerge overall a type of hierarchy of institutional oversight and control for the preferential systems. The most complete systems to be contemplated provided for the lowest degree of voting control as prior authorisation was not required, but these formations imposed the strictest conditions upon coverage. The Economic Development and Reconstruction preferences required pre-approval by two-thirds of the Members present. The least complete exchanges also required no voting authorisation, but these exchanges could not be closed to other qualifying Members and preferences exchanged were to be temporary in nature.

\textsuperscript{14} Havana Charter (1948), Article 15:4, (a)-(f). Other conditions are stated in the Article which are not mentioned here.

2.2.3 The Havana debate regarding future preferences

As further recounted by John Jackson, the provisions for free-trade areas and the other provisions of what we now understand as Article XXIV were included in the Havana (1948) ITO Charter as Article 44 of Part IV, titled Commercial Policy. These provisions replaced the earlier Geneva Charter (1947) text by a special protocol. According to F.A. Haight, the new text, including for the first time the provisions for the free-trade area exception, was recommended by the subcommittee and was approved without any substantive debate.

However, prior to the referral of the full committee to the subcommittee, an extensive discussion concerning the role of future preferential systems in relation to the MFN clause was held in Havana. These reported discussions by the Commercial Policy Committee (Committee III) extended over four meetings held in early December of 1947. Provided under the title of a "General Discussion" of Chapter IV (Commercial Policy), most of this commentary was dedicated to recording the positions of the parties regarding the unconditional MFN clause (Article 16) together with its negotiated standstill provisions for annexed (pre-existing) preferential systems. The issue raised was the manner in which these Geneva provisions had provided for a standstill for the existing preferential arrangements, but subjected future regional arrangements to a voting approval. Thus, at the centre of discussion was the relationship between the MFN Article on the one hand, and the development preferences provided by Article 15 and the customs union Article (Article 42) on the other.

In reviewing the country-representative comments made during these meetings, it is apparent that many Havana parties were unsettled by the MFN compromise that had been reached at Geneva. Particularly controversial for the members was whether future preferences should be encouraged or discouraged, and if permitted, whether they should be subject to voting pre-approval by the organisation. This difficulty applied to both preferences that could be characterised as either "development" or "regional" in orientation. Thus, from the first meeting, the Syrian representative indicated the country's support for most-favoured nation treatment, "but pointed out that exceptions had been admitted which would permit the continuation of existing preferential arrangements representing vested interests. However, there were certain countries within the same economic area, having traditional relationships which should not be overlooked even though these had not been formalized. His delegation had submitted amendments, both in Geneva and here, which would permit the conclusion of new preferential tariff agreements for such economic areas."

Likewise, the representative of Iraq noted that, "He believed that preferential arrangements between small producing areas having complementary trade would not cause the dislocation which Article 16 was designed to prevent. Customs unions, although permitted under Article 42, required a long time to establish and involved administrative difficulties. Therefore preferential arrangements should

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16 J. Jackson, Supra note 7 at p. 578, citing at note 14, "Special Protocol Relating to Article XXIV of the GATT", 1948 (Agreement No. 7 in App. C). However, during the Havana process, the Article was referred to as Article 42, "Territorial Application of Chapter IV, Frontier Traffic and Customs Unions", rather than Article 44, its numbered Article in the final Havana Charter. This reflected the Charter's division of Article 42 into three separate Articles.

17 F.A. Haight, 1972, p. 393, citing E/CONF.2/C.3/SR.44 and 47. This point is often cited to support the proposition that the free-trade area exception was not particularly well considered in the drafting, and occasionally to reflect upon the quality of the drafting itself.

18 Summary Record of the Commercial Policy Committee (Committee III). These meetings were reported at Havana between 3 and 11 December 1947 as meetings Four Through Eight. E/CONF.2/C.3/SR.4 through SR.8.

be permitted as well as customs unions and supported the Syrian, Lebanese and Turkish proposals in this respect.\(^{20}\)

The representative of Lebanon referred his comments directly to a proposal for the inclusion of provisions for preferential arrangements other than customs unions as he,

"...felt that one solution for the handicap (sic) of small countries with limited markets was regional co-operation through customs unions, free trade agreements, or preferential tariff agreements. His country knew the difficulties of customs unions and it was doubtful if many would be formed. He would present amendments to Articles 16 and 42 to allow free trade and preferential agreements for economic regions. He saw no reason why the smaller countries should not exchange preferences in order to compete with highly developed countries which did not need them or which might not be ready to reciprocate.\(^{21}\)

It is evident that the development preferences provided in Article 15 were not considered by these parties to be sufficient, either because of the voting waiver required, or because of a desire to create larger regional markets, or as necessary to take into account more comprehensive development approaches. It is likely that many objecting parties blended all of these aspects in their orientation to seek a broader avenue for future regional systems.

The argument to include provisions for regional preferential systems other than customs unions appeared also to turn in part on the view that the negotiated standstill for certain pre-existing preferences, as provided in Article 16, was simply unfair to territories that were contemplating future systems. Thus, while the representative from Australia indicated that development preferences were already possible by Article 15 of the Charter (upon prior approval), the Venezuela representative indicated that, "he could not understand why the prior approval of the Organization was required for some and not for others."\(^{22}\) Likewise, from the following meeting, Argentina expressed the concern that the MFN clause, "included exceptions for the benefit of certain countries and perpetuated discriminatory practices condemned elsewhere. Those exceptions should be made more equitable by the inclusions of complementary economic regions."\(^{23}\) These comments suggest that the necessity of the MFN compromise reached in Geneva had its ramifications for the issue of future preferences in Havana.

It is helpful to note at this juncture that there was no reason to believe that Article 15 would not survive and be finally incorporated in an adopted and ratified Havana Charter. The inference to draw from this fact is that the later drafting of a free-trade area provision was not then contemplated to be a replacement for the Development Article's provisions. Since there was opposition to the pre-approval requirements contained in Article 15, it is at least likely that members, seeking an expanded possibility for future preferences without pre-approval, also found common ground with those who sought a regional grouping exception with lesser administrative severity than posed by the customs union requirement. A comment from the Chilean representative during the third meeting suggests as much as he,

"...stated that his delegation would advocate general provisions for preferential arrangements on a regional basis rather than the specific provisions of paragraph 2, Article 16, for the reason that, within the purposes of the Charter, provisions should be made for all, and the

\(^{20}\) Ibid., at p. 1-2.

\(^{21}\) Ibid., at p. 3. This comment contains the first reported reference from this debate to "free-trade agreements."

Not only were these three middle-eastern countries supportive of the concept. A later note by Haiti indicates that the twelve countries in the Central America trade zone also sought a preferential system, although the term free-trade area is not used in that reference. Ibid., at p. 4.

\(^{22}\) Ibid., at p. 6. Furthermore, "he strongly supported the need for preferential arrangements for such groups of countries as the near East, Central America, other Latin-American countries and other geographic regions."

present preferential arrangements including those of his own country, were too limited to attain the expansion of trade envisioned by the Charter. It was possible to use the same arguments for establishing preference for economic regions as for customs unions.\textsuperscript{24}

The conference record indicates generally that there was a large number of countries committed to Charter additions which would permit less strict criteria for the creation of future preference systems, notwithstanding the unconditional MFN clause as incorporated in Article 16. As the representative of Ecuador noted, "It was significant that forty of the countries represented at the conference considered the system of preferential treatment indispensable to profitable world trade."\textsuperscript{25}

The argument against new preference systems was not however neglected on the record, as indicated by the comments of Australia, the United Kingdom and the United States. Thus, the Australian representative indicated opposition to regional arrangements (other than customs unions), but saw a need for small countries seeking to develop industries in inadequate markets to have access to certain preferences, but rather upon an individual article or commodity basis and with prior approval. From his view, the provisions already made in Articles 15 and 42 were quite adequate for this purpose.\textsuperscript{26}

The UK representative indicated that while existing preference systems were granted a standstill, "new preferences were not to be established and the existing ones were subject to a progressive reduction or elimination...If the creation of new preferences were not subject to examination by the Organization, the position would have to be examined."\textsuperscript{27}

Although comments by the United States are not prominent in these reports, the representative (Mr. Leddy) did express the position that,

"(E)conomic regional preference arrangements were not a promising device for economic development. Special circumstances justifying such an arrangement should be submitted to the Organization for its decision as to the net gain to world trade, otherwise the whole object of eliminating preferences would be undermined."\textsuperscript{28}

From these reports, one can begin to see the outline of how a free-trade area exception could have provided an avenue for compromise to meet the various positions. First, the waiver for new preferences would not be required, but waiver would remain necessary for partial or individual sector preferences. The desire for regional formations to create larger markets could be respected where the proponents intended to exchange a sufficiently high number of preferences so as to emulate the regional trade characteristics that were already acknowledged for customs unions. With this higher bar in place, MFN might have a chance to establish itself, first through the standstill provisions for existing systems, and second, by requiring a more rigorous exchange for new systems. By providing the developing parties a means of bypassing the 2/3's voting requirement for more complete future regional systems, the perceived unfairness of the standstill permitted for pre-existing systems was less at issue. For partial or sectoral exchanges, the existing Development chapter would continue to apply.

Given the extensive debate and differences of opinion recorded prior to the referral, it is possible that the subcommittee report granting the new free-trade area exception reconciled the various objections

\textsuperscript{24} E/CONF.2/C.3/SR.6 at p. 3. Paragraph 2 of Article 16 provided for specific permitted preferences. In response, the France representative indicated concurrence with the notion of regional organisations, "but with the prior approval of the Organization, as a means of protecting third parties." Interestingly, this was opposed by the representative of Syria, which stated that it was unable to agree with France on the question of prior approval. Ibid at p.4.


\textsuperscript{26} Ibid., at p. 3.

\textsuperscript{27} Ibid., and apparently suggesting that the price paid for a standstill which would restrict the Commonwealth preference in the future was a system of pre-approval for new preferences.

\textsuperscript{28} Ibid., at p. 4.
that were already on record. Thus, to only add to Haight's comment above, the record may well disclose that there was a good reason why the new free-trade area provisions were passed without any need for significant further debate.

2.2.4 The introduction of a free-trade area exception

The debate recounted above also indicates that the question of future preferences was central to the consideration of the MFN obligation in the Havana forum. This was reflected by the terms of reference made in the referral to the drafting subcommittees, which was charged, "To consider and submit recommendations to both Committees regarding Articles 15, 16 (2) and (3) and 42...with a view to finding a solution of the question of new preferential arrangements."

The Report of the Joint Sub-Committee of Committees II and III on Articles 15,16 and 42" was reported on March 7, 1948 as E/CONF.2/C.3/78. A working party of this subcommittee held 29 meetings, the results of which formed the basis of the report.\(^{29}\) Since the subcommittee was charged with viewing three Articles, changes to the proposed Article 15 were also forwarded to the Co-ordinating Committee of the Congress, and described in a separate report for which no citation is available. For the Article 42 provisions, according to the subcommittee report, "The text of Article 42 has been redrafted on the basis of proposals by the French delegation, the main change being to extend to free-trade areas the provisions relating to customs union, as requested by the delegations of Lebanon and Syria.\(^{30}\)

As far as the inclusion of free-trade areas, an explanation of Article 42B stated that, "The second paragraph, providing for the establishment of customs unions, is based upon paragraph 2 (b) of the Geneva draft, but there has been added to it a new provision covering the establishment of free-trade areas. An amendment proposed by the United Kingdom (C.3/11, Item 10) has been incorporated, and it is felt that the new text of the Article largely covers an amendment proposed by Chile (C.3/11, item 11)."\(^{31}\)

Finally, the report indicates that, "(I)n paragraph 4 the definition of a customs union, which was contained in the second sentence of paragraph 4 of the Geneva draft, has been amended and a definition of a free-trade area has been added. This describes a free-trade area as a group of two or more customs territories within which tariffs, etc. (except where necessary, those permitted under section B of Chapter IV and under Article 43) are eliminated on substantially all the trade between the constituent territories or at least on substantially all the trade in products originating in such territories."

2.2.5 Havana conclusion

The Havana Article 15 provisions, as referred from the subcommittee, retained its pre-approval conditions. These were already opposed on record by a fair number of participants. It must be considered therefore that the inclusion of a free-trade exception in Article 42 was posed as an alternative solution which would permit regional preferences within wholly formed systems rather than partial systems, but absent customs union administrative formalities and the requirement of a 2/3

\(^{29}\) The working group's report is contained in E/CONF.2/C.283/A/134, unavailable.

\(^{30}\) C.3/11, Item 13. E/CONF.2/C.3/78, page 5, italics added. ("This subject was considered to be of sufficient importance to require its separation from the other matters dealt with in Article 42, and accordingly the Sub-Committee recommends a separate article devoted exclusively to customs unions and free-trade areas." Ibid.

\(^{31}\) Ibid., at p. 6, para. 23.

\(^{32}\) Ibid., at p. 7, para. 27.
approval. As such, the inclusion of the free-trade area exception may well have reflected a compromise whereby pre-approval for sectoral preferences was retained, but then also granting a simplified construction to those parties seeking to form complete regional entities but without the customs union requirements to establish territory treatment. Overall, such an inclusion might have served to rebalance the Geneva arrangements in light of the larger group of developing participants who were not parties to the earlier round and flowed in part as a consequence of the compromise reached in Geneva.

If this is correct, this conclusion at Havana reflected a substantial departure from the position of the drafters during the process in Geneva. The Geneva Charter itself was modified from the U.S. State Department proposals for customs union and frontier traffic exceptions only by the inclusion of permitted interim agreements. Since the commentators cited agreed that the purpose of the entire ITO exercise from the U.S. view was to terminate the use of preferences in international trade, then one would conclude that the U.S. either acquiesced in the compromise, did not become aware of it, or had already determined that the ITO process was doomed. The first suggestion seems the most likely.

While this author has not been successful in locating the subcommittee reports, one point remains persistent. The Havana provision for free-trade areas in Article 42 introduced this term for the first time into the commercial policy lexicon. As drawn from both Whidden and Viner regarding inter-war systems, the various terms for preferential systems in the period did not employ any formation known as a free-trade area. Since such a regional instrument was simply unknown in the pre-GATT practice, Viner drew the conclusion, which retains a certain relevance now, that "This term is introduced, as a technical term, into the language of this field by the Charter, and its meaning for the purposes of the Charter must therefore be sought wholly within the text of the Charter."34

Three ramifications are considered. First, the GATT Articles themselves must form the primary source as to what would constitute the nature of the requirements. Second, to the extent that the free-trade area provisions are identical to those for customs unions, any previous practice developed to customs unions does have an informative role in determining the meaning of terms applied to free-trade area requirements when ambiguity occurs. Third, in the absence of experience with a free-trade area exception, where the functioning of such an area could not be compared to customs unions practice, then the implications of including the exception were not likely to be able to be appreciated at the time of the drafting. What is developed below is that within a short time after the Article became effective, that the inclusion of the free-trade area exception necessarily compelled an attempt to make a new legal distinction in practice between such an "area" and the previously condemned notion of partially preferential arrangements. This problem may have been exacerbated by the loss of the Development Article, which arguably would have served as a text providing demarcation. Whether or not that is the case, drawing any consistent line across this terrain would prove to be a most troublesome endeavour for GATT Parties, and one which even continues to trouble the review process of regional agreements in the contemporary practice.

2.3 The effect of Havana provisions

As indicated, pre-existing margins of preference between particular countries were negotiated to be subjected to identification and a standstill obligation according to Article I:2 of the GATT (Havana Charter Article 16:2). Preferential systems introduced thereafter were not to have been easily installed and qualified for MFN exceptions. Dam emphasised the restrictive nature of the new Article XXIV gateway and the structural link between the provisions of Article I and Article XXIV as,

34 J. Viner, Supra note 1 at p. 124.
"...the principal objective in the drafting of the customs union and free-trade area provisions became to tie down, in the most precise legal language possible, the conditions that such regional groupings would have to fulfil in order to escape prohibition under the most-favoured nation clause as preferential arrangements." \(^{35}\)

Jackson's view of the relationship between the two provisions was similar in part as,

"...the fear of some countries that the regional exception could be abused to allow the introduction of detrimental preference systems otherwise inconsistent with MFN was the motive power behind the elaborate draftsmanship that went into the other clauses of the regional exception." \(^{36}\)

In point, both comments present a revealing view of the intent of the drafters as it reflected two compromises reached, the first being the standstill arranged in Geneva and the second being the inclusion of the free-trade area exception in Havana. However, the elaborate draftsmanship suggested by Jackson was mainly settled at Geneva, since customs union provisions were essentially extended to free-trade areas at Havana. When that first compromise had been reached, the criteria that would either secure it or permit it to be degraded by future commercial practices would likely have received a fair degree of attention by the drafters in regard to any language to be employed for other exceptions. Whatever exceptions are made possible by Article XXIV would serve as the primary gateway to offer or accept a preference outside the parameter of Article I MFN. Therefore, in the absence of the "the most precise legal language possible", the value of the negotiated standstill for existing systems would have provided for little additional meaningful restraint on the introduction of new preferential systems. This could not have been the intent of the drafters, even in consideration of the compromise reached in Havana for free-trade areas.

2.3.1 Extending customs union requirements to free-trade areas

Such a view of the restrictive interpretation for Article XXIV finds support from an often-quoted summary of the American justification for advancing the customs union exception. From Clair Wilcox,

"A customs union creates a wider trading area, removes obstacles to competition, makes possible a more economic allocation of resources, and thus operates to increase production and raise planes of living. A preferential system, on the other hand, retains internal barriers, obstructs economy in production, and restrains the growth of income and demand...A customs union is conducive to the expansion of trade on a basis of multilateralism and nondiscrimination; a preferential system is not." \(^{37}\)

The Wilcox statement is most often cited now for its failure to appreciate the possibility of Viner's trade diverting customs unions. However, the quotation also retains validity on its own merits by disclosing how parties may have viewed a free-trade area requirement in contrast to other types of preferential systems. This is to view the phrase not from its economic implications, but how it might inform a legal view of the hierarchy established for preferential systems, and how free-trade areas should be placed within such a hierarchy. Thus, one notes the difference above between the two types

\(^{35}\) Italic s added. K. Dam, Supra note 6 at p. 275. Considering that Kenneth Dam adhered to the view that Article XXIV:4 should be re-interpreted to accommodate a more Vinerian approach in qualifying regional systems, that he would also identify the strict linkage between the Article I compromise and the provisions for Article XXIV, as contemplated by the drafters, is noteworthy. See also, J. Jackson, Supra note 7 at p. 602, and citing therein K. Dam, (1963), at p. 663.

\(^{36}\) Although, several paragraphs later, he states that, "...the conclusion can be drawn that the compromise of the GATT draftsmen was intended to retain for GATT parties a considerable amount of the existing latitude to enter into regional arrangements of various types." J. Jackson, Supra note 7 at p. 600 and 602.

\(^{37}\) Clair Wilcox, A Charter for World Trade, Macmillan, New York, 1949, pp. 70-71, quoted in Dam, Supra note 6 at pp. 274-275, italics added.
of preferential systems. This appears to turn upon the quality of internal free trade to be attained by the parties, as a preferential system "retains internal barriers" between the members. A customs union admittedly would have the legal capacity to eliminate such internal barriers. Although the Wilcox statement was generated before the free-trade area provisions were introduced at Havana, query how U.S. policy makers would have treated the exception as extended if they applied these criteria. If one assumes that the final result was compatible with the U.S. position, then a conclusion can be formed that free-trade areas were permitted upon the understanding that they would also eliminate internal barriers to trade in a manner similar to a customs union. Otherwise, and in light of Dam's notation above, there would be an absence of a legal basis to make any distinction between free-trade areas and disfavoured partially preferential systems. The intent of the drafters as to MFN would be overall undermined in the absence of such a distinction. Regional formations eliminating internal barriers to trade would therefore be supported as an MFN exception.  

Perhaps the strongest evidence in support of this view is the parallel textual identity of the requirements for the removal of barriers to trade for both legal forms, as both require that duties and other restrictive regulations of commerce... are eliminated on substantially all the trade."  

In the absence of documentation to the contrary, it follows that the simple correlation of the provisions indicates an expressed intent to equate the internal trade requirements for both forms. Since customs unions already benefited from a practice of receiving exceptions from the various bilateral treaties employing MFN clauses, a regional free-trade area agreement that met the same conditions internally could also be exempted, even in the absence of a common external tariff.

In support for this view, the requirement for the removal of barriers to trade remained consistent from Geneva through Havana, even as the free-trade exception was brought forward. The Geneva text provided that,

"A customs union shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that all tariffs and other restrictive regulations of members of the union are substantially eliminated and substantially the same tariffs and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union."  

To compare, the final Havana text portion of Article 44 provided as follows:

"A custom union shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that duties and other restrictive regulations of commerce (except where necessary, those permitted under Section B of chapter IV and under Article 45) are eliminated with respect to substantially all the trade between the constituent territories of the union (or at least with respect to substantially all the trade in products originating in such territories)"

There are two differences between the versions. One is a change in placement of the term "substantially" from the first draft's reference to tariffs and regulations (i.e., substantially all tariffs eliminated on the trade), to the second draft's position in reference to trade (i.e., duties eliminated on substantially all the trade). The other change is the addition in the second version of a listing of specific Articles designated as exceptions from the primary stated requirement. In the larger context, we know that the free-trade area provisions were also added. The question to raise is whether the

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38 One can only speculate into which category Wilcox would have placed free-trade areas, as the term appeared later. Given the elements supplied in the statement, one could suggest that free trade areas eliminating all internal barriers to trade would have been favourably viewed as similar to customs unions.

39 Article XXIV 8(a)(1) for customs unions, Article XXIV(8)(b) for free-trade areas.


41 Italic added, subparagraph indicators omitted.
change in placement of the term "substantially" might have any relation to the inclusion of a free-trade area provision, and if so, what? Robert Hudec and James Southwick have suggested the connection of the change in the placement of the term to the addition of the exception Articles listing. This would allow the second version to contemplate with more ease the notion that not all sectors need be covered to meet the requirement. The exceptions themselves as listed point to the possibility that some traded sectors may not be covered under the obligation.42

This is plausible even while the change might have also accommodated the free-trade area exception. On this point, one would consider the position of the drafter in attempting to delineate the new category of free-trade areas from other partially preferential arrangements. To draw a line for which non-customs unions arrangements would pass under Article XXIV, it may also have been the case that the placement was shifted to emphasise that partial rollbacks in duties and quantitative restrictions across a broad range of trade would not suffice for the requirements. Even while the second version more easily contemplates the elimination of coverage for sectors, at least according to the listed Articles, the requirement is arguably overall strengthened in designating that the elimination of duties and other restrictive regulations of commerce is a requirement. In this sense, the change in placement could also have reflected the introduction of free-trade area provisions as necessary to reflect a demarcation that was being intended between free-trade areas and lesser forms of partial preference systems.

Viner noted an additional change. This is shown for customs unions whereby the elimination is to be effected for "all trade in products originating in such territories", rather than all the trade between such territories. According to Viner, this change reflected the circumstance that arose by an absence of a traditional definitional requirement that would have provided for allocations of customs revenues among members.43 However, this change also can reflect an intent to make more parallel the requirements between free-trade areas and customs unions, since in the former arrangement the non-harmonisation of external commercial policy would necessitate a requirement that only goods of origin to each free-trade area member would be covered. While this is a softened requirement as compared to the Geneva Draft, it also indicates a closer alignment between the two situations that were under contemplation for the exception.44

2.3.2 Conclusion on the Havana provisions

Whether the changes made as discussed above were consciously enacted in order to align the existing provisions with those of the new free-trade area is a matter of speculation in the absence of subcommittee drafting reports. However, what is disclosed from the face of the provisions resulting in Havana is that the difference between the two forms is not found in any of the provisions regarding the internal trade requirements to be met by either. The only difference between the two forms that is identifiable in the text itself is that which relates to the external policies required to be adopted, since a customs union is required to substitute a common external tariff and a free-trade area may retain its individual member tariffs.

The intent of the drafters is therefore apparent from the provisions viewed overall. While an exception was being recognised for a new "regional" formation which did not create a customs territory, this

43 "(A) customs union set up without provisions for such allocation would need the benefit of this relaxation unless it was prepared to accept assignment of revenues according to place of collection." J. Viner, Supra note 1 at p. 114, his note 15. Viner considered this to be a meaningful diminution of the traditionally accepted requirements.
44 This also suggesting that the elimination of "other restrictive regulations" was not intended to reach to the elimination of internal administrative checks for either customs unions or free-trade areas as would be necessary to determine the origin of the goods.
free-trade area would nevertheless be required to meet the same test as a customs union, whatever that test might be, in regard to the elimination of its internal barriers to trade.

Although subcommittee documentation is scant, this conclusion is well-supported from the identity of the provisions themselves, and not least, from the referral comment made by the subcommittee itself. As quoted above, the main change was, "...to extend to free-trade areas the provisions relating to customs union..." Such an extension would have reasonably served to retain the legal hierarchy that was being established. This allowed for a distinction between formations which fell under the customs union and free-trade area Article, those which fell under the Development chapter, and those that would not be permitted to be entertained by Organisation Members in deference to the new MFN obligation.

The final section will review Article XXIV requirements imposed upon regional parties in regard to the quality and degree of their internal trade to be liberalised and make an examination of the sequence of the Article's paragraphs to be applied.

2.4 Overview of Article XXIV requirements: sequence of conditions

GATT Article XXIV imposes two primary sets of requirements for the formation of a regional trade arrangement to operate as an exception from its Article I Most-favoured Nation obligation. One set is definitional in nature as it outlines the categories of arrangements that fall within the provisions of the Article. The other set of requirements establishes certain implementation conditions whereby agreements otherwise qualified by definition, may nevertheless be denied the Article's application where the external trade affects of the agreements raise new barriers overall to other GATT Parties. The logical way to approach a reading of the Article is to commence at the point where definitions are applied. This determines the scope of the Article in respect to the types of arrangements possibly exempted from GATT Article I.

2.4.1 The first test: paragraph 8 definitional requirements

Article XXIV:8 (paragraph 8) is the first to consider in any evaluation as it acts to identify the characteristics of those regional trade agreements which must be present in order to qualify for an exception to the MFN principle. Thus, either a free-trade area or a customs union,

"...shall be understood to mean an area (or territory) where duties and other restrictive regulations of commerce are eliminated with respect to substantially all the trade between the constituent territories."

This provision provides a definition for the two types of regional formations in terms of the amount of trade upon which action is to be taken (substantially all) and the actions that are to be taken regarding it (elimination of duties and other restrictive regulations of commerce). As drafted, an initial definitional requirement is imposed, since if a preferential arrangement would fail to eliminate the designated barriers on the appropriate amount of trade, then according to the paragraphs' own terms, such a formation shall not be understood to constitute either a free-trade area or a customs union. Therefore, the Article, and whatever exceptions it may accord, is expressly not intended to be applicable for an arrangement that does not fulfil these requirements, no matter its declared form or title as designated by its members. What is suggested is that some affirmative act of factual qualification is to be undertaken in order to determine that any particular arrangement meets the tests described so that it may be concluded that a free-trade area or customs union is being created. The subject of this qualification relates to the intra-regional or internal trade of the area or union. The

45 GATT Article XXIV:8(a)(1) for customs unions, and GATT Article XXIV:8(b) for free-trade areas (emphasis added). At this point we are not interested in the listed Article exceptions stated in paragraph 8(a) and (b). The complete text of the Article as provided in GATT-1947 is attached by Annex.
paragraph requires that in order to be characterised as either a free-trade area or a customs union, that the trade to be considered is the trade between the members for their goods of origin.46

Other provisions support the proposition that the Article requires this definitional qualification. The provisions of paragraph 10 provide the additional mechanism whereby the Contracting Parties may approve proposals that do not qualify with the Article’s other requirements by a 2/3 majority vote. This waiver is explicit however in only being available where, "such proposals lead to the formation of a customs union or a free-trade area in the sense of this Article."47 Thus, even Article XXIV’s waiver provision makes a requirement that a paragraph 8 free-trade area or customs union must inevitably result. Further confirmation is found in the obligation imposed by paragraph 7 of the Article for proponents to submit a plan and schedule to demonstrate that the arrangements made are sufficient to meet the definitional test. Thus, 

"If, after having studied the plan and schedule...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 within the period contemplated...the CONTRACTING PARTIES shall make recommendations... The parties shall not maintain or put into force...such agreement if they are not prepared to modify it in accordance with these recommendations."48

In this context, the principle reason why the Article would require a plan and schedule should be understood to provide the material for the Contracting Parties to review agreements proposed in order to apply the tests as stated in paragraph 8. On this basis, the Contracting Parties can then fulfil their stated obligation to make recommendations in those cases where an agreement does not result in either of the recognised forms. Thus, the Article requires an action by the Contracting Parties to distinguish between free-trade areas and customs unions on the one hand, and all other preferential arrangements on the other, and as a matter of fact.

There is a second aspect of the internal trade requirement that can be considered at this point. This requires that the removal of duties and other barriers be done so on a mutual basis. For customs unions, this is indicated by Article XXIV:8(a)(i) which refers to "...trade between the constituent territories of the union..." For free trade areas, the comparable requirement is found in Article XXIV:8(b), which refers to, "...trade between the constituent territories in products originating in such territories."49

For customs unions only, there is an additional element of a definitional character that relates to the external aspects of the formation. This is found in Article XXIV:8(a)(ii) whereby, "substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union." This flows from the nature of a customs union as

46 The term "free trade" is applied in this context to refer to the elimination of tariffs and quantitative restrictions. For now, the Article's term "other restrictive regulations of commerce" is applied here to indicate the removal of quantitative restrictions.

47 The paragraph 10 provision is applicable for customs unions and free-trade areas between GATT parties and non-parties. GATT, Analytical Index, Guide to GATT Law and Practice, Geneva (6th Ed), 1994, p. 770. An Article XXV waiver, requiring for GATT-1947 for 2/3 majority of the votes cast would serve as the appropriate avenue for any formation which would not result in either a customs union or a free-trade area. The voting requirement is more strict than that provided by GATT Article XXIV:10, since the final formation, although not complying with other Article XXIV conditions, does eventually meet the definitional requirement of Article XXIV:8.

48 GATT Article XXIV:7(b), emphasis added. A discussion of the effect of "non-decisions" concludes chapter 5.

49 Emphasis added. It may be that the obligation would be better expressed as a "mutuality" requirement rather than that of reciprocity. The latter term is however consistently used to designate the requirement. Over the period of implementation there is no stated requirement that duties be reduced between the parties at the same rate. The inference is that within the time contemplated by the plan and schedule, a result shall be reached whereby both parties have eliminated their respective barriers to trade.
expressed by paragraph 8(a), “as it is understood to mean the substitution of a single customs territory for two or more customs territories...” Although this requirement relates to the external aspects of a customs union, it is a requirement that yet remains definitional in nature in defining the character of a union’s regime which must be present in order to qualify for any exception under Article XXIV.

2.4.2 The second test: paragraph 5 requirements regarding external effects

After meeting the definitional tests required by Article XXIV:8, then a consideration of how the formation will affect other GATT parties in implementation is made according to Article XXIV:5. This paragraph grants the exception accorded by Article XXIV for customs unions and free-trade areas, provided that the effects of the implementation of the regional trade agreement do not impose higher barriers to trade upon other GATT Parties. Thus, it is required, that in respect to the trade of other contracting parties, that the duties and other regulations (maintained or imposed), "shall not on the whole be higher or more restrictive" than "prior to the formation".

Any elimination of an internal barrier to trade between two parties is a preference and equivalent to a raising of the relative barriers to non-members. However, Article XXIV:5 does not require nor suggest an interpretation that the overall effect of a qualified formation must leave the external trade in exactly the same position as prior to the formation. Otherwise, a partially preferential agreement could be more qualified for an Article XXIV exception where its effect overall was to raise fewer relative barriers to non-members. Any such reading would negate the Article XXIV:8 trade-coverage requirement outright.

This consideration reinforces the intended sequence to be applied to the Article's provisions. First, the proponents submit a plan and schedule which contains sufficient elements to demonstrate that a free trade area or a customs union can be realised. Second, they then provide sufficient evidence according to the plan and schedule that they will not implement this otherwise qualified formation in any manner that would raise new trade barriers to the other GATT parties. Therefore, the second test, while certainly not incidental, must nevertheless be undertaken only in regard to actual changes which occur in the external trade regimes of the regional parties and only for arrangements which are already qualified according to the definitional requirements of paragraph 8.

2.5 Chapter Conclusion: opposing views of regional integration

As we will see throughout the next Part, the interpretation and sequence of applying paragraphs 5 and 8 have formed primary fault lines for GATT Parties to disagree over the requirements of Article XXIV. As the first requirement outlined above requires regional parties to establish free trade between them, and since these benefits will not be granted to non-members, the GATT Article most directly affected by a regional formation is Article I, the Most-favoured Nation provision. But for the exception provided in Article XXIV, MFN would require that any preference offered by one regional party to another be likewise unconditionally granted to all other Contracting Parties.

Understandably, the motives attributed to support or oppose regional formations are also typically viewed in the same dichotomous frame as is presented by the objectives of paragraph 8 and paragraph 5. As Richard Snape has described the two positions, "(O)n one is that preferential discrimination permits countries to liberalize further than otherwise, by engaging in reciprocal reduction of barriers in agreement with like-minded countries. The other is that discrimination permits governments to raise, selectively, barriers

50 GATT Article XXIV:5(a) for customs unions, GATT Article XXIV:5(b) for free trade areas. There is a difference for free-trade areas where the higher duties shall not be "maintained". For customs unions, they may not be "imposed at the institution".

51 GATT Article I, reciting in relevant part, "...any advantage, favour, privilege, or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties."
against 'troublesome' exporting countries - and thus to bow to domestic protectionist pressures - in a manner in which they could not if the barriers had to be raised against all exporters, friends as well as foes.\textsuperscript{52}

This statement summarises the two tests to be applied, and if they were applied in a manner consistent with the stated terms of the Article itself, it is likely that the objections on both sides would be met. For the first, paragraph 8 would require that parties do in fact liberalise further than otherwise. For the second, paragraph 5 would act to eliminate selective barriers from being raised against "troublesome" exporting countries.

However, it might yet be suggested that it is paradoxical for Article XXIV to require a high degree of internal free trade in the first instance, as this would certainly appear to aggravate the possible effects of discrimination. However, this is precisely what the Article appears to require, and no less. Since all preferences are discriminatory and raise relative barriers to trade, non-members can always support incomplete formations that will discriminate against less of their trade overall. If the provisions of paragraph 5 constituted the sole criteria for the Article, or were capable of overriding the definitional requirements of Article XXIV:8, then the result would be to increase the number of partial preference agreements operating under a claimed exception to MFN. Although any one such partial agreement may be causing less damage to the trade flows of non-members, the sum total of more such agreements may cause more damage overall. As one proceeds to examine the application of the Article through GATT practice, a conclusion can be drawn that this is precisely what has occurred, perhaps even to the point of constituting GATT's legacy for the common practice according to the Article.