Regional Trade Agreements in the GATT/WTO: Article XXIV and the Internal Trade Requirement
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7 Part Three: Regionalism in the WTO

7.1 Introduction: a question for modern regionalism

The resurrection of MFN in the GATT era can be claimed to have had the effect of reducing the power of any one country to control the geographical distribution of its trade. Necessarily, where an exception to this rule was granted by GATT Article XXIV, the restrictions imposed by the Article can also be seen in this same context. In this view, the purpose of the Article would be to require such a high degree of trade coverage between regional proponents that the opportunities to exercise the control of geographic distribution would be reduced. For those which would occur in meeting the higher thresholds for coverage, the capacity to exercise a power to close dependent territory trade would be minimised.

A straightforward objection to revisiting Hirschman's thesis in the modern trading environment must be that while GATT has already installed MFN on a multilateral basis, it has therefore already served to rid the trading system of these onerous geographic strategies. This should be a given, except that the validity of the argument depends not only upon the quality of the legal criteria which has been provided, but also the capacity of the system to require adherence to it. This is the coherency aspect. On this point, it has already been noted that much of the modern criticism of Article XXIV has been advanced not only from the perspective that its application has lacked enforcement capability, but also that the underlying legal criteria was economically irrelevant in the first place.

As it was attempted to show in Part Two, the question of "compatibility" between regional formations and the GATT system has been promulgated primarily from the perspective of GATT parties who are excluded from the regional formation in question. It has been this interest in loss or gains for external trade that appears to be most closely associated with any idea of a "GATT system" interest. Limiting the perception of MFN to this concern only appears to narrow the framework within which MFN might have been intended to operate overall.

7.1.1 The character of the new regionalism

The legal and political setting within which Hirschman described the potential for the influence effect of trade must certainly be different after 45 years of MFN application within the GATT. Large and developed countries are not prohibitively closed. In the old setting, selected positive preferences could quickly induce dependency where the recipient's production was expanded to seize export opportunities in otherwise closed markets. GATT/WTO not only has a low-tariff environment but one wherein measures other than duties, i.e., quantitative restrictions, are also prohibited and actionable. Where these occur by exception they are nowhere as dominant as in the inter-war practice.¹

However, there are a large number of regional formations being established even after the conclusion of the Uruguay Round, and given the above factors, one must wonder as to what constitutes the motivation for the continuing persistence of regional trade agreements. A number of common possibilities are suggested. For examples, some say that the increase is a response to the risk of GATT failure to liberalise international trade at a sufficient pace. Of course, the developing and transition country regional partners should probably not recite this reason, since many also complain

that they need more time to enact the Uruguay Round obligations. These are assumedly enforcing liberalisation at a slower pace. Related, regional endeavours are also said to seek to stimulate GATT progress. This made sense in the frustrating eight years of the Uruguay Round but then, why would the number of regional agreements accelerate even after the Round concluded? Some say that that regionalism allows countries to achieve new thresholds of integration or to experiment with new liberalisation approaches without having to obtain the larger GATT consensus. However, examples of advanced integration are few and arguably, at least in respect of treatment of non tariff barriers, the free-trade area models generated by the NAFTA or the Europe Agreements are not that impressive. Some regional formations are claimed to also "lock-in" the process of economic transformation. Even before WTO however, GATT rules arguably succeeded also in this task, at least if one considers that the economic miracles of Asia through the 1970s and 1980s were promulgated in the absence of regional agreements. Finally, regional formations are said to reinforce traditional geographic and cultural linkages. Geography is a given of course, but the cultural implications of regional agreements appear as often to be a point raised in opposition to further regionalisation rather than as a basis for its appeal.

Common to all of these explanations is the absence of any expression by the proponents that any member is seeking to assert control over the geographic distribution of its trade. At least on the surface, the motivation suggested by Hirschman is not apparently a feature of our era.

7.1.2 Modern regional dependency

However, maybe a dependency motive in our non-autarchic world is not necessary anyway. For a number of important arrangements between developed and developing or transition market territories, intensive trade dependencies are evident in any case. For example, even before the NAFTA was formed the U.S. market absorbed 81% of Mexico's exports and acted as the origin for 80% of Mexico's imports. For the U.S. however, Mexico received only 7% of U.S. total exports and only provided 6% of its total imports.\(^2\) For the EC, so-called asymmetrical trade flows to central and eastern Europe countries (CEECs) have so characterised the development of trade that that the matter was raised as a political problem at the European Summit level. Thus, "(S)ince 1989 trade patterns between the Union and the associated countries have changed radically. Although the European Union now absorbs over 50% of the associated countries' exports they still only account for 4.2% of total European Union imports. In spite of the rapid rise in their exports to the Union, the Union's exports have risen even faster causing concern about the large trade deficit (5.6 billion ECU in 1993)\(^3\)

For the more advanced of the CEECs, 1995 exports to the EU comprised 62% of their total exports. Their imports from the EU equalled 61%, of which Germany generated 26%.\(^4\) Thus, trade dependency is a fact of life for new regional members regardless of any strategy intended to foster it. As Hirschman indicated, in the absence of the regional agreements MFN would control and territories would not have the ability to exercise any influence over the geographical orientation of their trade.

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\(^3\) According to Eurostat in 1993, the total of all CEEC exports as a portion of total imports to the EU was under 4.5%. CEEC imports as a share of all EU exports was 5.3%. Recited in European Commission, Com (94) 361 Final, 27-04-94, ANNEX II, and at p. 7. However, also in the case of the CEECs, this trade did not pre-exist the free-trade area agreements. Whether or not dependency was the point of the exercise, dependency resulted.

The manner in which trade and investment would flow to and from the other territories would be the result of the natural patterns of trade.

7.1.3 The influence of investment

Another difference from Hirschman's era might be the changed role of capital and investment across borders. The 1930's world was dominated by exchange controls whereas now the cost of relocating capital has decreased enormously. There is claimed to be a great competition between developing and transition countries to attract inward flows from the primary source territories, mainly the United States and Europe, but also Japan. Perhaps regional agreements relate to this process of attracting investment by guaranteeing the free-trade channels for the inputs and outputs of located production and by providing certain legal guarantees to secure investment or the treatment of investors. It is the case that a number of regional agreements in the modern times are hybrid in nature and encompass investment provisions of various sorts.

In this setting, positive preferences are not an end in themselves but rather serve as a means of facilitating the process of development. However, even while this explanation is more in tune with the reality of globalisation, it also does not say very much about the condition of dependency within regional settings, except to suggest that it may be more comprehensive across a range of traded factors other than just products. Occasionally the relationship between these elements is raised. As the European Commission noted the view of some of the Europe Agreement parties,

"The use by the Union of these commercial policy instruments (anti-dumping and safeguard actions) is perceived by the Europe Agreement countries as both a political and an economic problem; they believe that the existence of these instruments is likely to have a dampening effect on trade and inward investment." 6

7.1.4 The remaining trade barriers

The margin of preferences granted relative to MFN is also not completely irrelevant in the modern setting. The large and developed territories bound rates of duties are historically low overall, suggesting that their capacity to re-direct trade from one partner or another is limited. However, the external trade regimes of many of developing or transition-market regional partners may not exhibit such low tariffs nor be as comprehensively bound as their more developed partners. They can grant positive preferences that might have the power to favour the trade of a member relative to other suppliers. This could suggest the possibility of an increasing dependency upon the developed territory.

7.1.5 The political factor

A conclusion is still possible that the new regionalism differs too much from the era of Hirschman to allow any comparisons to be drawn. In the 1930's, regional political hegemony was in vogue and trade policy was an instrument of national power, allegedly used to relegate the small and neutral to one regional zone of influence or another. In the modern era the reality is supposed to be global and more economic than political. Thus, much attention is drawn to the global nature of competition between multinational firms as they are seen to compete in all markets, each other's as well as upon third markets. However, this also belies a different truth as support for new regional agreements also tends to be identified with proposals generated and then lobbied by the multinational firms themselves. If competitive life for them is global, then query what is the role of regionalism in the process of globalisation? The answer to this may lie in the fact that large developing and transitional markets are important growth markets. Regional preferences together with the investment factor provide the possibility for developing a meaningful competitive edge. Thus, while firms may compete globally they may do so by also enacting regional strategies. Likewise, they may defend markets regionally.

5 European Commission, Com (94), 361 final, at p. 8.
7.1.6 The factor of size

In assessing the consequences of regional arrangements for international trade, Pomfret appeared to reject the risk of emerging trading blocks as the primary threat. Rather, the proliferation of agreements between a large country and smaller clients caught his attention.

"Individually such PTAs may be of minor significance, but collectively they undermine the non-discrimination principle. The threat is more serious because the small country enjoys an alloyed economic benefits even if the scope of the scheme is unilaterally restricted by the large country, while the large country sees unquantifiable (and hence difficult-to-challenge) political benefits for which it is willing to pay small economic costs. Such arrangements proliferate because they face no checks and they tend to take the hub-and-spoke form which is least economically justifiable."

Whatever other difference may describe the difference between the trade diplomacy environment of the 1930’s and the 1990’s, Hirschman would have likely recognised the elements set forth in Pomfret’s statement. The large/small factor also appears to have played a role in raising a WTO criticism of the new regionalism.

7.2 A WTO ‘wake-up’ call

While the new wave of regionalism in the later years of the Uruguay Round emerged in force, the GATT Secretariat was otherwise occupied with the problems of concluding the Uruguay Round, and then later, with the administrative difficulties of establishing the new WTO as an organisation. The first Secretariat statement on the issues did not surface until 1995. The conclusions were tentative but tended to emphasise the potential for compatibility of regional arrangements with the multilateral trading system while noting that certain aspects might undermine compatibility.

7.2.1 Committee on Regional Trade Agreements (CRTA)

Institutional developments followed. The Singapore Ministerial Meeting (1996) called for an end to the ad hoc Working Party Review system of the GATT practice by establishing a standing review committee for regional agreements, the Committee on Regional Trade Agreements. The terms of reference made for the CRTA included the examination of new agreements and the reviewing of the operation of existing agreements, to improve the examination process and,

(d) “to consider the systemic implications of such agreements and regional initiatives for the multilateral trading system and the relationship between them, and make appropriate recommendations to the General Council…”

Over the first years of the Committee’s operation, there was solid progress made in outlining the systemic issues. However, while the parties could identify which aspects required clarification, they nevertheless continued to disagree on the substance of the answers that would free the process of

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6 Pomfret, Richard, The Economics of Regional Trading Arrangements, Clarendon Press, Oxford, 1997, p. 358-9. Pomfret does not accept the proposition that the rise of trading blocks is a significant problem. Rather, '(T)he danger sign for GATT in the 1980s lay in the diminishing number of important trading nations that accepted its principles as applying to their own trade policies.” Ibid. at 367.


9 Drawn from the 199 report of the CRTA to the General Council, WT/REG/8, 11 October, 1999.
evaluating particular agreements. Thus, while a large number of agreements continued to be notified, only one, the Czeck-Slovak customs union was able to receive an affirmative recommendation.\textsuperscript{10}

7.2.2 The focus on U.S. and EU regional activities

Thus, it appeared that aside from a bit more clarity as to what was at issue for interpreting Article XXIV, one could reasonably have assumed by 1999 that WTO practice would fairly imitate the pattern set in GATT-1947. However for observers it came as some surprise when a far more critical WTO viewpoint was expressed in 1997 in a Rome speech delivered by the Director-General of the new Organisation, Runato Ruggiero. As he addressed the participants of the Transatlantic Business Dialogue, his comments revolved around the same question posed above as he asked, "(D)if the logic of regionalism often makes less economic sense in an era of globalisation, why are we witnessing such a dramatic expansion of regional initiatives?" As he responded,

"(P)erhaps part of the answer could be that in some cases these initiatives are less about advancing regional economic efficiency or cooperation...and more about securing regional preferences, even regional spheres of influence, in a world marked by growing competition for markets, for investment and for technology. This, in my view, is potentially the most worrying feature of the new regionalism we see unfolding around the world today."

His reference to a world of regional spheres of influence is striking in its resemblance to the lexicon of the 1930's, and certainly not how the economic superpowers of the modern age would choose to see their role characterised in the WTO. However, the behaviour of the U.S. and the EU was central to the critique, as

"(W)hat makes this competition more worrisome is that at its heart lies the world's two major economic players - the United States and the European Union. What we see when we look at the pattern of regional expansion in the world today is essentially two focal points with concentric circles of preferential trade arrangements radiating outwards - almost as if they were competing to see who can establish the greatest number of preferential areas the fastest. If it is true that the strength of the multilateral system for fifty years rested on the strength of the transatlantic partnership, it is also partly true that the sudden proliferation of regional arrangements reflects a certain inability of the transatlantic community to co-ordinate its trade interests and vision.\textsuperscript{11}

The MFN implications of these regional developments were also considered. Thus,

"(F)irst, we must ensure that the foundation of the trading system remains non-discrimination as embodied in the two fundamental principles of National Treatment and Most-Favoured-Nation. Regional agreements which are preferential by nature represent an exception to the most-favoured nation treatment."\textsuperscript{12}

The manner in which MFN acts to delineate the distinction between liberalisation undertaken within the regional preferential setting as compared to the multilateral system does provide the key to framing the question of the compatibility of regional endeavours with the rules of the multilateral trading system. It may seem remarkable for the WTO, as keeper of the non-discrimination rule, to have taken so long to initiate a response to the new regionalism. But considering the inherently

\textsuperscript{10} According to the Synopsis of "Systemic" Issues Related to Regional Trade Agreements, Note by the Secretariat, WT/REG/W/37, 15 February, 2000, p. 10. According to the 1999 CRTA Report, 118 RTAs have been notified to the GATT/WTO.


\textsuperscript{12} Ruggiero address, Ibid.
diplomatic and intergovernmental nature of the organisation and the important role the U.S. and EU play within it, it is perhaps surprising that any criticism from the Director General was made at all. Since the commentary was directed to the two economic superpowers, and since these territories were founding parties of the GATT, they should most of all appreciate the value of MFN. So then, what possible changes occurred in this relationship to permit the promotion of regionalism and the apparent expense of the principle? The answer to this question may have a bearing upon the question of whether Hirschman’s world is one behind us or ahead.

7.2.3 Large-country diplomacy: what constraints remain?
While GATT 1947 imposed only a weak form of institutional restraint, real constraints on national prerogative were relaxed only as the conclusion of the cold war has translated into new political and economic realities. According to Drestler,

"The global geopolitical transformation has left three economic power centres - America, Europe, Japan - with no common adversary to bind them. This does not necessarily make them enemies to one another - indeed, continued global well being depends on their continued cooperation. But the security imperative no longer constrains them; the United States is no longer motivated to mute its economic demands to strengthen its alliances, and our allies are no longer driven to yield economically because they are dependent militarily."  

The establishment of the GATT in 1947 coincided with the initiation of this period of imperative constraint, or perhaps more accurately, with the economic version of it, in being portrayed at that time as necessary to defend the market economies against the growth of state socialism. That GATT was eventually viewed in this manner was demonstrated by the arguments made by Cortney to reject its more conciliatory predecessor, the Havana Charter for the International Trade Organisation (ITO):

"(T)he Havana Charter attempts to reconcile fundamentally conflicting ideas or objectives. It claims to make possible normal business relationship between countries dominated by state-socialism (and using planning for 'full employment') and countries where the individual competitive capitalism is prevailing. The Charter hopes to promote at the same time 'full employment' and free multilateral trade."  

If the GATT and its non discrimination rules derived any legitimacy from the imperative to defend the market system from the rise of Communism, then the demise of the Soviet model could also suggest

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13 I.M. Drestler, American Trade Politics, 2d edition, Institute for International Economics, 1992, Washington, pp. 210-212. An example of the role for governments in competition for global markets is the implementation of market opening strategies in both the U.S. and the EC. In both, firms are provided a streamlined and administratively assisted access to complain of foreign market barriers. This type of assist is arguably healthy where the national procedures are required to invoke GATT/WTO rules for dispute resolution determinations. For the EC, Council Regulation No 3286/94 of 22 December, "Laying down Community procedures in the field of the common commercial policy in order to ensure the exercise of the Community's rights under international trade rules, in particular those established under the auspices of the World Trade Organization", a/k/a the New Trade Barriers Regulation. 1994 OJ L 349, p. 71.

14 Cortney, Philip, The Economic Munich, Philosophical Library, New York, 1949, p. 23. The ITO charter and its provisions made reference to accommodating full employment policies that were not carried over to the GATT. An anti-Soviet argument did not succeed to create support for the later attempts to upgrade GATT to full organisation status. By this time, other activities which related more directly to the Soviet threat were also set in place, notably the Marshall Plan and NATO. Gardner, Richard, N., Sterling-Dollar Diplomacy in Current Perspective, Columbia University Press, New York, 1980, p. 73. Much later in the 1970's, the U.S. administration actively viewed the GATT and its MFN clause as a political instrument in the policy known as "differentiation", undertaken to promote the GATT accessions of several central European countries. See generally, Huis, Leah, Globalizing the GATT, The Brookings Institution, Washington, D.C. 1992.
that a re-examination of this legitimacy would also be set into motion.\textsuperscript{15} On reflection, one can suggest that the multilateral MFN principle over this last century has not yet been tested for its capacity to bind the major actors in an economic environment other than that of the cold war exigency. That such a re-evaluation commenced in the closing years of the cold war is also shown by a number of commentators who claimed that the GATT and its principles had already outlived their usefulness. Bhagwati summarised their critique in 1991 as,

"(T)he facile views of GATT's impotence are fashionable in the United States among several lobbies and in Congress. They principally reflect panic at the payments deficit and at the rise of Japan. Quick fixes on the trade front, using American muscle to extract trade concessions unilaterally and quickly from others, regardless of the impact on the world trading regime, therefore have a superficial but compelling appeal."\textsuperscript{16}

By the mid-1990s however, the Japan "problem" had also outlived its usefulness. Absent the competitive Japan threat, Bhagwati's categorical concerns about US policy for its obsession with unfair trade, managed trade, aggressive unilateralism, and regionalism could all have been fairly claimed to have been only episodic events.\textsuperscript{17} If Japan was no longer a popular threat to the United States' economic power, then one could have safely concluded that the era of U.S. disillusion with the GATT should also have been at an end. However if as Bhagwati suggested, the GATT 1947 was being subjected to a strong challenge during the period when imperative constraint controlled U.S. behaviour, then what factor would serve as a constraint on U.S. policy upon the conclusion of the cold war?\textsuperscript{18}

7.3 New-world regionalism

The case for developing a critical view of regionalism in the WTO should rest upon factors other than the sheer volume of agreements notified to the GATT/WTO during and after the conclusion of the Uruguay Round.\textsuperscript{19} Rather, the focus should be placed upon the legal nature of the agreements being

\textsuperscript{15} For definitional purpose, "When it is asserted that a rule or its application is legitimate, two things are implied: that it is a rule made or applied in accordance with right process, and therefore that it ought to promote voluntary compliance by those to whom it is addressed. It is deserving of validation." Franck, Thomas, M. (1995), \textit{Fairness in International Law and Institutions}, Clarendon Press, Oxford, p. 26.


\textsuperscript{17} This is shown by Bhagwati's equation of the US situation to the position of Britain at the end of the nineteenth century, as both were victims of the "diminished giant syndrome". "Fair trade' and 'reciprocity' were the buzz words in Britain then, and they are in the United States now." J. Bhagwati, ibid., at 16. "Perhaps the most important factor, responsible in particular for the American conversion to neurosis on this front, has been the relative decline of the United States within the world economy, leading to what I christened some years ago the diminished giant syndrome." Ibid, at 15-16.

\textsuperscript{18} To trace the evolution of a position in favour of US bilateralism, see Dombusch, Rudiger, W., \textit{The Case for Bilateralism}, in Salvatore, D., (ed.) \textit{Protectionism and World Welfare}, Cambridge University Press, Cambridge, 1993, pp. 180-199, "The case made here for bilateralism in no way questions the usefulness, past, present and future of the GATT system. Rather it advocates that there is room for, and indeed a good reason for a parallel track (to) move on to a bilateral basis." Ibid., at p. 181.

\textsuperscript{19} The European Commission reported that of the 69 preferential trade agreements notified to the GATT since 1947, and currently in force as of the end of 1996, 39 of these agreements were notified since 1990. EU Commission, 1997(a). According to the Director-General of the WTO, "Since the entry into force of the GATT in 1947, 163 regional trade agreements were notified to the GATT or the WTO. In the period 1986-1991 only five agreements were notified to the GATT; the equivalent number for the period 1992-1996 is 77. Of these 163
entertained and upon the goals sought to be achieved by the proponents in contrast to their rights and obligations within the multilateral system. For this purpose, it is noteworthy that many of the regional trade agreements notified under the WTO appear either as initiatives of the U.S. and the EC, or as a type of response to their earlier initiatives.

7.3.1 The focus on transition economies

The focus of regional attentions is also evident as many parties to the agreements appear to be transition market economies. Not every country in market transition has become a signatory to a regional trade agreement with one of these leaders. But, free-trade area agreements, together with services and investment provisions, do appear to have become the primary legal mechanism applied to relate the former centralised economies to the market system. Not all of these agreements retain geographic proximity. Examples of out-of-market initiatives include the EU-Mexico free-trade area and the increased preferences being granted to certain African countries by the U.S. Both the U.S. and EC are active in negotiating free-trade agreements in South America. The FTAA hemispheric construction is inherently a U.S. conception and the EC negotiates for a free-trade area with the MERCOSUR.

7.3.2 EC initiatives

Regional formations are not new for the European Community and the increase in EC regional agreements over the last decade does seem to reflect the changes in the European landscape. This is associated with the demise of Soviet authority over the Central and Eastern European Countries (CEECs), specifically, the demise of the COMECON system over individual state external relations, and the resulting openings to the west. The primary reference point for these changes is the Europe Agreement (Association Agreements) framework for the establishment of free-trade areas with ten of the Central and Eastern European countries. The choice of regional trade arrangements in this

agreements, around 60 per cent are currently in force. Thus over three quarters of the operational regional agreements in existence today have entered into force in the last four years." Ruggiero Speech, 7 November 1997, Supra, note 11.

20 Defined here as territories formerly closed to trade or investment due to government ownership of production or restrictive government controls upon trade and foreign exchange. The WTO Committee on Regional Trade Agreements (CRTA) of the WTO, organised to report on notified agreements posted its work schedule for 1996. Of 32 reviewed for that period, the 20 following notifications are suggested here to fit this characterisation: NAFTA, goods & services; EC agreements with the Czech Republic, Slovak Republic, Hungary, Poland, Romania, Bulgaria, Latvia, Estonia, Lithuania, Turkey; EFTA agreements with Poland, Hungary, Romania, Bulgaria, Slovenia; Switzerland agreements with Estonia, Latvia, Lithuania. Source, WTO Focus Newsletter, June-July 1996, No. 11, p. 10. The 1999 Annual Report of the CRTA to the General Council, WT/REG/8, 11 October 1999, provides a later listing of notified agreements and is attached as an annex.

21 Neither Russia nor India is in a preferential trade agreement with either the U.S. or the EU. According to Fred Bergsten, regional trade agreements formed or forming constitute 60% of total world trade. He provides the following summary table for 1994 showing each arrangement's share of total world trade: APEC (exclusive of its subregional agreements) -23.7%; European Union - 22.8%; NAFTA - 7.9%; (other arrangements not shown). Intra-EC trade should probably be omitted from his account. His list does not include the FTAA, Free Trade for the Americas. According to Bergsten, India and Russia have both applied to the APEC (Asian Pacific Economic Co-operation). China is already an APEC member. Fred Bergsten, Open Regionalism, The World Economy, August 1997, pp. 545-566, at p. 555 (Table 1) and 551.


23 The Europe Agreements evolved from the context of cold war relations between the EEC and those countries within the Soviet sphere of influence, and in the context of the GATT, See, A. M. Van den Bossche, GATT: The Indispensable Link Between the EEC and Hungary?, Journal of World Trade, V. 25, No. 3, 1991, pp. 141-155; D.
context is justified by reference to the endpoint of European integration by accesssion to the European Union. This movement has set in motion a number of revisions and demands for revisions to the pre-existing universe of EC regional agreements. By now, most have been either upgraded, the EC-Turkey and Mediterranean Agreements for examples, or are in the process of re-negotiation (EC-Lomé Convention). The pattern of upgrading these relations to reflect the EC’s new approach of utilising free-trade areas with investment and services provisions is apparent.24

7.3.3 U.S. initiatives

The United States also employs free-trade areas as its primary legal regional vehicle, but unlike the EC, the U.S. is a new regional actor. Although the projection of a consistent regional trade policy has met with difficulties in Congress and in the public domain, a commitment to a regional strategy has remained steadfast for the Executive Branch over the last three presidents.25 Early justifications for the US to become a regional actor were often based on the case for pressuring the European Community and others to make settlements in the Uruguay Round. However, the policy in favour of regional agreements has continued since the conclusion of the Round and the entry into force of the WTO. Thus, by accident or otherwise, the end of the cold war has coincided with the emergence of the United States as a pursuer of the free-trade area model.26 Two of the US regional proposals deserve note. The countries of Central and South America have formed a continental centre of regional attention even while they have set upon unilateral and conventional market reforms. For this region the US and Canada act as developed-market anchors within the Free Trade for the Americas (FTAA).27 More ambitious, at least geographically, is the promotion of a free-trade area to be concluded within the framework of the Asian Pacific Economic Cooperation (APEC). By its 1994 Jakarta Declaration, the governments comprising nearly all of the countries which border the Pacific

Horovitz, “The Impending ‘Second Generation’ Agreements Between the European Community and Eastern Europe—Some Practical Considerations, Journal of World Trade, V. 25, No. 2, 1991, pp. 55-80. Existing Europe Agreements are in force with Estonia, Latvia, Lithuania, Poland, The Czech Republic, The Slovak Republic, Hungary, Romania, Bulgaria, Slovenia. Likewise, individual member countries of the European Free Trade Association (EFTA) have also initiated free trade area agreements with most of these countries. In addition, a number of CEECs have entered into the Central Europe Free Trade Area (CEFTA). In all, the CEEC connected agreements account for a good portion of the agreements notified to the GATT since 1990.

Arrangements with Turkey are historically bound in the customs union framework, but the transition market aspect is apparent as the renewed EC-Turkey customs union formalises, primarily on Turkey’s part, an intent to open its highly protected market to the EC and to apply a number of essential EC internal market legal regimes. The formative proposals for a new European Union approach to the Mediterranean also have the aspect of upgrading the relationship by encouraging (or requiring) these territories to open to each other and to the EC. Proposals for Lomé at this writing, appear to encompass a number of free-trade areas for the more developed Members of the Convention.

26 Presidents Reagan, Bush and Clinton, two Republicans and one Democrat. The Office of the United States Trade Representative is within the Executive branch of government and holds the rank of Ambassador. The USTR serves by appointment of the President and upon Congressional approval.

27 During the cold war, the U.S. refrained from such agreements and acted as a primary critic of other territory formations. The United States did not oppose the formation of the EEC. This formation was presented to the GATT as a customs union plan and met most of the traditional elements maintained as consistent with GATT territory formation. Objections were made regarding member state preservation of quantitative restrictions and agriculture provisions. L778, 1958 BISD, 6th Supp., pp 68-89.
Ocean, including the U.S., Japan and China, have indicated a ministerial commitment to establish free trade on the Pacific Rim by the year 2010.28

7.3.4 Regional competitions

Between the United States and the European Union, although EU-related arrangements form the largest number of individually notified regional agreements to the WTO, the cause of concern for the upsurge in regionalism is viewed by some to be mainly attributed to the entry of the United States. According to Bhagwati,

"The main driving force for regionalism today is the conversion of the United States, hitherto an abstaining party, to (GATT) Article XXIV...(T)he conversion of the United States is of major significance. As the key defender of multilateralism through the postwar years, its decisions now to travel the regional route (in the geographical and preferential senses simultaneously) tilts the balance of forces at the margin away from multilateralism to regionalism."

In the same exchange, Baldwin agreed with the implications raised by the change in U.S. policy, but drew a wider picture by noting the rise of U.S. non tariff measures and the use of its unfair trading laws during the 1980's. Together with its interest in regional trade agreements, these,

"...are all efforts aimed both to bring pressure on GATT members to change the rules as the United States wishes and to explore whether the country can do better outside of the GATT multilateral framework."30

Pomfret noted that the EC was first in the accumulation of its “special cases” and recited Patterson’s earlier predictions on the fundamentals of discriminatory preferences. As he summarised Patterson, each new discriminatory trade policy weakened the international system based on non-discrimination by eroding the share of world trade carried out under MFN conditions; by increasing conflicts among beneficiaries of complex preferential systems; by encouraging dissatisfaction in countries sticking to the non-discriminatory policies (because other countries were seen as stealing a march on them); and by undermining the legitimacy of GATT.31 For Pomfret, the shift in U.S. policy in the early 1980's was an important step along this course as it had been the bulwark against discrimination since the late 1930s.

28 With extensions to 2020 for developing members. Asia Pacific Economic Co-operation Forum (APEC), Declaration of Common Resolve, November 15, 1994, 34 I.L.M. 758. See also, Achieving the APEC Vision, Second Report of the Group of Experts, 1994. According to the WTO, APEC comprises 40 per cent of the world’s population, some 54 per cent of the world’s GDP, and 42 per cent of its trade. Ruggiero speech, 7 November 1997, Supra note 11. A difference between FTAA and APEC is that the former is intended explicitly to qualify as a free-trade area under GATT Article XXIV. While APEC members have made tariff-cut commitments, the treatment of any cuts in excess of Uruguay Round bindings is not settled. There does remain some concept in APEC that further cuts would be used to leverage other GATT parties either multilaterally or conditionally. If the latter would occur, the agreement would have to be qualified first by Article XXIV.


30 Discussion by Robert Baldwin, Ibid., at p. 53. According to Baldwin, these policies are responsive to the increased foreign competition facing import competing industries (textiles, apparel, steel, autos) as well as by the demands of export-oriented sectors such as computer chips and other high technology products. Contrary in part, Richard Blackhurst takes the view that the Bhagwati opinion regarding the U.S. conversion to regionalism understates the country’s commitment to a successful Uruguay Round completion. Discussion by Richard Blackhurst, Ibid., at p. 55.

"Symptomatic of the erosion of the MFN principle's standing was the cavalier manner in which US officials talked of exploring new trade policy paths in the early 1980s; even after the CVERA and USA-Israel free trade area had been finalized, they were referred to as 'tentative tests' of a new approach."

While the United States has received some attention for its shift in policy, the transition-market elements of the new regionalism have not received much treatment even from those who ascribe political-economy factors as primary to the phenomena. For example, Krugman attributed the rise of trading blocks (his term) to four factors: the excessive number of participants in the GATT, the difficulty of the negotiation space and the absence of reliable monitoring tools (grey area measures); the institutional differences between countries, especially Japan where tariff reductions are not perceived to actually open markets; and finally, an American position no longer preoccupied with trade, "as a binding agent in a political and military struggle". According to him, regional trading arrangements became favoured as a means to reinstate the bargaining environment where all of these problems could be diminished.

What is also evident in only the few years since Krugman's summary is that these factors have become less relevant, except for perhaps the last one. Monitoring orderly marketing arrangements is expressly required by GATT Article XIX as revised. If anything, unsupervised safeguards measures may now pose more of a problem when applied between regional members. The view of Japan's trade policy may continue to be an issue, but perhaps not a very important aspect as its economy and global competitiveness have slumped through the 1990s. The desire to negotiate in smaller groupings can always be cited as a valid motive, but then again the diversity of the APEC and the FTAA groupings also do not suggest that the United States is seeking smaller pools of like-minded parties.

Krugman's final factor does remain persistent in suggesting that the United States no longer views itself as the party primarily responsible for the multilateral system and its MFN clause, or if it does, that it no longer associates this task with restraint upon its regional agenda. If so, then the idea that this change has also generated a new regional competition for spheres of influence between the US and the European Union should not be so surprising. That the end of the cold war opened the prospects for new competitions also seems to follow.

7.3.5 The question of "open regionalism"

The role of MFN as it applies to regional preference represents an old issue that apparently requires periodic revival. As such, a first mythology that is confronted by recalling the role of MFN is the notion that regional overtures are always compatible with the goals of the trading system merely because both processes reduce trade barriers. As stated, since free trade is a good thing, a free-trade agreement with a particular territory (Mexico, Chile, South Africa, etc...) is likewise also good and should therefore be promoted by government policy. Unfortunately for the multilateral system, the same reasoning is also adopted for the reverse and the WTO is jeopardised as a result. Thus, the dislocation effects of a particular free-trade arrangement are bad, free trade is therefore bad and WTO must also be bad.

32 R. Pomfret, Ibid., at 368. "The language could not be in starker contrast to Cordell Hull's zeal for a non-discriminatory trade regime." Ibid., and citing Weintraub (1986) for the absence of reaction in the U.S. regarding the policy change.

33 Paul Krugman, Regionalism Versus Multilateralism: Analytical Notes, in De Melo, J., and Panagariya, A., Supra, note 28 at pp. 74 and 75.

34 That this reasoning is amiss is demonstrated by the position of those in the U.S. who opposed both the passage of NAFTA as well as the Uruguay Round implementing legislation, even though the GATT/WTO set of rules acts as the only multilateral legal limitation on regional formations.
The GATT/WTO is probably accurately attributed with maintaining as a goal the formation of an integrated global economy. This objective should be open to debate on the value of its own merits. However, whether or not one supports this goal, it is also clear that the GATT/WTO system of legal rules seeks to impose upon the process a condition that developments should occur according to the non-discrimination principle. Thus, GATT's purpose is all about the matter of not permitting special advantages to accrue between territories, except according to certain excepted circumstances. To contrast, regional formations are really all about the business of developing special relationships and advantages by one territory one behalf of another, no matter the degree of historical or cultural propinquity that may be raised to validate them.

A number of new regional endeavours openly hedge the MFN problem as they are self-dedicated to the support of the multilateral rules via the expressed concept known as "open regionalism". While this innovative term remains wholly undefined in GATT legal practice, it can not be presumed that this theory of open preferences will find endorsement as compatible with the Article XXIV rules if and when it is ever tested. Historically, the notion of a "low tariff club" appears to be analogous. In those systems, members exchanged preferences and then offered them to other territories on the condition that they would also reduce their barriers. While low-tariff club models were known to the GATT drafters to examine for their possible application in a new multilateral system, they were never adopted as a legal model for the exception provisions. Instead, Article I MFN was settled to be an unconditional obligation. Article XXIV also makes no accommodation for a conditional open regionalism approach, unless of course a grouping would first be validated as either a free-trade area or customs union. Only then may members choose to offer positive preferences to non-members on a reciprocal basis as they may choose. However, MFN will also apply to the reductions made by any outside party who has determined to reciprocate. So, they too must grant their new tariff cuts on an MFN basis to all other WTO Members or alternatively, formally accede to the grouping by the use of a free-trade area or customs union. This "rolling" form of trade liberalisation was passed-over in favour of provisions for multilateral negotiation rounds intended to include all Members. One may offer as a reason, that the low tariff club concept permits groupings of parties to form together to dictate the terms of liberalisation to be adopted by the other Members. MFN becomes a conditional obligation rather than one unconditional.

7.4 Extending GATT rules to regional members

The new regionalism is certainly not conducted in the same legal environment as that described in the 1930's and 1940's. While Hirschman's thesis was brought forward prior to the restoration of MFN in the GATT, his view was retrospective to the era when MFN was not predominant, and when applicable, was often attempting to be applied to the allocation of quantitative restrictions in an environment of nearly prohibitive tariff duties. In the GATT era, MFN has been installed as a point of legal reference for regional endeavours. The results of the Uruguay Round also show that MFN has been reinforced throughout the annexed Agreements, both in the detailing of legal regimes and for traded sectors such as agriculture and textile products. Thus, where new regional agreements fail to accommodate MFN as a form of minimum treatment between partners, a major difference posed by the WTO is that the resulting levels of treatment between them may now fall below a level which has evolved to potentially provide for actual market access. As Roessler has noted, "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".

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35 Recalling Whidden's terminology from section four of chapter one.
This comment confronts the conventional wisdom that regional agreements are only instigated to provide for deeper liberalisation than that able to be accorded by the GATT/WTO. Rather, what is suggested directly by Roessler’s statement is that instead of instigating “WT0 plus” regimes, regional members may be able to develop a formidable means of avoiding them. As the WTO developments to provide less flexibility for discrimination in regard to national policies generally, the regional solution may offer an escape avenue for the continued exercise of national prerogative that can be directed at the regional level. Although this result is inconsistent with our understanding of the legal security understood to be provided for the members of the WTO, it is also evident through the period of GATT 1947, that the MFN principle has never been determined authoritatively to govern intra-regional regimes. Rather, the record is full of references to the nature of regional formations as lex specialis. If the major parties view Article XXIV as a type of waiver from GATT obligations generally, then who is to say that quality of treatment lesser than MFN may not be accorded between members?

All can agree that the multilateral system has matured and that large country actors are now constrained in a manner that would have appeared utopian to Hirschman. The WTO’s integrated dispute system now permits the small to challenge the large with an increased certainty that the effort, when successful, will not be merely blocked. Powerful unilateral selective instruments, like the U.S. section 301, have been subject to challenge, even if there remain constraints upon the smaller territories to raise such challenges on their own behalf. The other instruments traditionally cited for their unilateral, discriminatory and non-compensatory characteristics have also been tightened in the WTO. A new safeguards understanding for Article XIX appears to expressly prohibit grey-area measures and requires notification and multilateral supervision of safeguards by an established WTO Committee. Injury and conditions for compensation are clarified, by and large to the benefit of the smaller parties. Even anti-dumping procedures are said to have become more regular and transparent, eliminating certain troublesome accounting regimes that were alleged to have led to inflated injury margins. The concept of de minimis has been imposed and sunset rules are now coming into force to retire older antidumping actions.

In light of these and other improvements to the system, one could argue that for the purpose of re-establishing selective discrimination, Article XXIV formations present one of the last great system loopholes for national prerogative. Thus, it is posited here that while many of the conditions have been greatly altered over the years, that the motive for regional formations in this era may not be so much different than that of the pre-GATT era. What appears to finally be common to both is the presence of intent to affect trade flows along geographic lines by the use of preferences, positive for sure, and possibly negative as well.

The chapters contained in this next Part represent an attempt to document some of the mechanisms that may be applied to exercise internal negative discrimination within modern regional groupings. This investigation is inherently anecdotal by nature, but is also governed with an eye to the applicable WTO regimes that are arguably invoked to support these preferences.

7.4.1 Chapter outlines for Part Three

Thus we establish the following sequence for study. Chapter Eight considers the choice of a legal form at the outset as free-trade areas are ubiquitous and possibly constitute a more receptive vehicle for employing negative preferences between regional members. One problem unique to free-trade areas is the requirement of rules of origin. While it has long been argued that the formulation of such rules can divert external trade and should therefore be examined in formations according to GATT Article XXIV:5, this chapter is oriented instead to viewing origin rules as they might fall under an examination according to GATT Article XXIV:8. We also raise the issue of cumulation as a result of multiple free-trade agreements with a single party.

Chapter Nine will address the legality of trade restrictive measures applied between regional members. The analysis first considers whether modifications suspending GATT obligations between any two GATT parties are permitted (or not prohibited) according to the General Agreement. If there
is a conclusion that such bilateral arrangements are not lawful under GATT, except as they may be validated according to an Article exception or GATT waiver, then the question of whether Article XXIV can serve to validate such measures is undertaken. The conclusion of the chapter is that Article XXIV does not establish any conditions for the application of a general waiver under GATT law. Therefore trade restrictive measures incorporated into free-trade area plans do not derive an exception by the operation of Article XXIV.

Chapter Ten considers especially the situation of regional safeguard measures. This appears to be a primary area of consideration for the application of negative preference between members. While most free-trade areas employ lex specialis regimes to address the problem of increased imports and injury, the position taken here is that GATT Article XIX and the WTO Agreement on Safeguards has legal control and is not likewise waived or modified by regional safeguard regimes. Therefore a non-complying regional safeguard that is applied selectively against another regional member is a violation of GATT Article XI. Examples of safeguard measures avoiding MFN and notification employed in both Europe Agreements and the NAFTA are provided for illustrations.

Chapter Eleven brings the topic into the contemporary situation with the conclusion of two WTO panel and Appellate Body reports in regard to certain aspects of Article XXIV. These cases are viewed as building upon the unreported panel cases from the GATT era, discussed in chapter 5. However, in going beyond that jurisprudence, the power of panels to address the compatibility of a regional trade agreement with the conditions of Article XXIV is asserted in the Appellate Body Report regarding the Turkey-EC customs unions on the questions of textile quotas. There is also a clear ruling on the position of Article XXIV paragraph 4, in that it expresses ‘purposive’ language rather than a distinct legal obligation. The second WTO case is that of the matter of Argentina safeguards on footwear products. While the Appellate Body in that case does not rule on the question of whether safeguards may be prohibited between regional members, there is a clear outcome that Article XIX and the Safeguards Agreement continues to apply to the external applications of safeguards by regional members. We draw from this the possibility that the test enunciated for permitting the violation of GATT rules as to non-members may also be applicable to members.

The book will conclude with Part IV, Chapter Twelve, returning to the systemic issues as they have been identified in the modern practice of the Committee on Regional Trade Agreements. For those that fall within the subject matter of this discussion, the rulings and reasoning of the WTO dispute cases is applied to determine how much resolution on these issues can be suggested by these developments. This establishes the basis for concluding the book on the prospects for additional developments in the CRTA.