INTERNATIONAL TRADE LAW
THROUGH THE CASES

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Unit VIII: Globalism v. Regionalism (GATT Art. XXIV)

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Supplementary Reading

For further reading on Regional Trade Agreements and the WTO we suggest the following:

Peter van den Bossche and Werner Zdouc, The Law and Policy of the World Trade Organization, 5th ed. 2021, 730-753.

Raj Bhala, Modern GATT Law. A Treatise on the General Agreement on Tariffs and Trade, Vol. 2, 2nd ed., 2013, 363-425.

Michael J. Trebilcock, Robert Howse, and Antonia Eliasson, The Regulation of International Trade, 4th ed. 2013, 83-136.

John H. Jackson, William J. Davey, Alan O. Sykes, International Economic Relations: Cases, Materials, and Text on the National and International Regulation of Transnational Economic Relations, 7th ed. 2021, 431-466.

1. Introduction

1-1. Overview of Regional Integration

WTO Secretariat's Introduction to Regionalism and the WTO:

Available at http://www.wto.org/english/thewto_e/whatis_e/tif_e/bey1_e.htm. (last visited Jan. 24, 2025).

Regionalism: friends or rivals?

Whether they are bilateral trade pacts, large customs unions, or cross-continental trade agreements, all WTO members as of June 2016 have some sort of regional trade agreement in force. These agreements have increased in number as well as complexity since the early 1990s. One of the most frequently asked questions is whether these regional groups help or hinder the WTO's multilateral trading system. WTO members, working in various committees, work to address such concerns.

Regional trading arrangements

Regional trade agreements (RTAs) seem to compete with the WTO, but often they can actually support the WTO's multilateral trading system. RTAs, defined in the WTO as reciprocal preferential trade agreements between two or more partners, have allowed countries to negotiate rules and commitments that go beyond what was possible multilaterally. In turn, some of these rules have paved the way for agreement in the WTO. Services, intellectual property, environmental standards, investment and competition policies are all issues that were raised in regional negotiations and later developed into agreements or topics of discussion in the WTO.

The WTO agreements recognize that RTAs can benefit countries, provided their aim is to facilitate trade among its parties. They also recognize that under some circumstances these agreements could hurt the trade interests of other countries. Normally, setting up a customs union or free trade area would violate the WTO's principle of non-discrimination for all WTO members ("most-favoured-nation"). But Article 24 of the General Agreement on Tariffs and Trade (GATT), Article 5 of the General Agreement on Trade in Services (GATS) and the Enabling Clause (Paragraph 2(c)) allow WTO members to conclude RTAs, as a special exception, provided certain strict criteria are met.

In particular, the agreements should help trade flow more freely among the countries in the RTA without barriers being raised on trade with the outside world. In other words, regional integration should complement the multilateral trading system and not threaten it.

1-2. Legal Texts

Read carefully the following primary sources, excerpted below.

- Article XXIV:4-10 GATT 1994
- Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994
- Article V GATS 1995
- The "Enabling Clause"

General Agreement on Tariffs and Trade (GATT) 1994

Article XXIV

Territorial Application – Frontier Traffic – Customs Unions and Free-trade Areas

4. The contracting parties recognize the desirability of increasing freedom of trade by the development, through voluntary agreements, of closer integration between the economies of the countries parties to such agreements. They also recognize that the purpose of a customs union or of a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories.

5. Accordingly, the provisions of this Agreement shall not prevent, as between the territories of contracting parties, the formation of a customs union or of a free-trade area or the adoption of an interim agreement necessary for the formation of a customs union or of a free-trade area; Provided that:

(*a*) with respect to a customs union, or an interim agreement leading to the formation of a customs union, the duties and other regulations of commerce imposed at the institution of any such union or interim agreement in respect of trade with contracting parties not parties to such union or agreement shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such union or the adoption of such interim agreement, as the case may be;

(*b*) with respect to a free-trade area, or an interim agreement leading to the formation of a free-trade area, the duties and other regulations of commerce maintained in each of the constituent territories and applicable at the formation of such free-trade area or the adoption of such interim agreement to the trade of contracting parties not included in such area or not parties to such agreement shall not be higher or more restrictive than the corresponding duties and other regulations of

commerce existing in the same constituent territories prior to the formation of the free-trade area, or interim agreement, as the case may be; and

(*c*) any interim agreement referred to in sub-paragraphs (a) and (b) shall include a plan and schedule for the formation of such a customs union or of such a free-trade area within a reasonable length of time.

6. If, in fulfilling the requirements of sub-paragraph 5 (a), a contracting party proposes to increase any rate of duty inconsistently with the provisions of Article II, the procedure set forth in Article XXVIII shall apply. In providing for compensatory adjustment, due account shall be taken of the compensation already afforded by the reductions brought about in the corresponding duty of the other constituents of the union.

7. (*a*) Any contracting party deciding to enter into a customs union or free-trade area, or an interim agreement leading to the formation of such a union or area, shall promptly notify the CONTRACTING PARTIES and shall make available to them such information regarding the proposed union or area as will enable them to make such reports and recommendations to contracting parties as they may deem appropriate.

(*b*) If, after having studied the plan and schedule included in an interim agreement referred to in paragraph 5 in consultation with the parties to that agreement and taking due account of the information made available in accordance with the provisions of sub-paragraph (a), 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 by the parties to the agreement or that such period is not a reasonable one, the CONTRACTING PARTIES shall make recommendations to the parties to the agreement. The parties shall not maintain or put into force, as the case may be, such agreement if they are not prepared to modify it in accordance with these recommendations.

(*c*) Any substantial change in the plan or schedule referred to in paragraph 5(c) shall be communicated to the CONTRACTING PARTIES, which may request the contracting parties concerned to consult with them if the change seems likely to jeopardize or delay unduly the formation of the customs union or of the free-trade area.

8. For the purposes of this Agreement:

(*a*) A customs union shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that

(i) duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) 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, and,

(ii) subject to the provisions of paragraph 9, 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;

(*b*) A free-trade area shall be understood to mean a group of two or more customs territories in which the duties and other restrictive regulations of commerce

(except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated on substantially all the trade between the constituent territories in products originating in such territories.

9. The preferences referred to in paragraph 2 of Article 1 shall not be affected by the formation of a customs union or of a free-trade area but may be eliminated or adjusted by means of negotiations with contracting parties affected.* This procedure of negotiations with affected contracting parties shall, in particular, apply to the elimination of preferences required to conform with the provisions of paragraph 8 (a)(i) and paragraph 8 (b).

10. The CONTRACTING PARTIES may by a two-thirds majority approve proposals which do not fully comply with the requirements of paragraphs 5 to 9 inclusive, provided that such proposals lead to the formation of a customs union or a free-trade area in the sense of this Article.

* * *

Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994

Members,

Having regard to the provisions of Article XXIV of GATT 1994;

Recognizing that customs unions and free trade areas have greatly increased in number and importance since the establishment of GATT 1947 and today cover a significant proportion of world trade;

Recognizing the contribution to the expansion of world trade that may be made by closer integration between the economies of the parties to such agreements;

Recognizing also that such contribution is increased if the elimination between the constituent territories of duties and other restrictive regulations of commerce extends to all trade, and diminished if any major sector of trade is excluded;

Reaffirming that the purpose of such agreements should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other Members with such territories; and that in their formation or enlargement the parties to them should to the greatest possible extent avoid creating adverse effects on the trade of other Members;

Convinced also of the need to reinforce the effectiveness of the role of the Council for Trade in Goods in reviewing agreements notified under Article XXIV, by clarifying the criteria and procedures for the assessment of new or enlarged agreements, and improving the transparency of all Article XXIV agreements;

Recognizing the need for a common understanding of the obligations of Members under paragraph 12 of Article XXIV;

Hereby *agree* as follows:

1. Customs unions, free-trade areas, and interim agreements leading to the formation of a customs union or free-trade area, to be consistent with Article XXIV, must satisfy, inter alia, the provisions of paragraphs 5, 6, 7 and 8 of that Article.

Article XXIV: 5

2. The evaluation under paragraph 5(a) of Article XXIV of the general incidence of the duties and other regulations of commerce applicable before and after the formation of a customs union shall in respect of duties and charges be based upon an overall assessment of weighted average tariff rates and of customs duties collected. This assessment shall be based on import statistics for a previous representative period to be supplied by the customs union, on a tariff-line basis and in values and quantities, broken down by WTO country of origin. The Secretariat shall compute the weighted average tariff rates and customs duties collected in accordance with the methodology used in the assessment of tariff offers in the Uruguay Round of Multilateral Trade Negotiations. For this purpose, the duties and charges to be taken into consideration shall be the applied rates of duty. It is recognized that for the purpose of the overall assessment of the incidence of other regulations of commerce for which quantification and aggregation are difficult, the examination of individual measures, regulations, products covered and trade flows affected may be required.

3. The "reasonable length of time" referred to in paragraph 5(c) of Article XXIV should exceed 10 years only in exceptional cases. In cases where Members parties to an interim agreement believe that 10 years would be insufficient they shall provide a full explanation to the Council for Trade in Goods of the need for a longer period.

Article XXIV:6

4. Paragraph 6 of Article XXIV establishes the procedure to be followed when a Member forming a customs union proposes to increase a bound rate of duty. In this regard Members reaffirm that the procedure set forth in Article XXVIII, as elaborated in the guidelines adopted on 10 November 1980 (BISD 27S/26-28) and in the Understanding on the Interpretation of Article XXVIII of GATT 1994, must be commenced before tariff concessions are modified or withdrawn upon the formation of a customs union or an interim agreement leading to the formation of a customs union.

5. These negotiations will be entered into in good faith with a view to achieving mutually satisfactory compensatory adjustment. In such negotiations, as required by paragraph 6 of Article XXIV, due account shall be taken of reductions of duties on the same tariff line made by other constituents of the customs union upon its formation. Should such reductions not be sufficient to provide the necessary compensatory adjustment, the customs union would offer compensation, which may take the form of reductions of duties on other tariff lines. Such an offer shall be taken into consideration by the Members having negotiating rights in the binding being modified or withdrawn. Should the compensatory adjustment remain unacceptable, negotiations should be continued. Where, despite such efforts, agreement in negotiations on compensatory adjustment under Article XXVIII as elaborated by the Understanding on the Interpretation of Article XXVIII of GATT 1994 cannot be reached within a reasonable period from the initiation of negotiations, the customs union shall, nevertheless, be free to modify or withdraw the concessions; affected Members shall then be free to withdraw substantially equivalent concessions in accordance with Article XXVIII.

6. GATT 1994 imposes no obligation on Members benefiting from a reduction of duties consequent upon the formation of a customs union, or an interim agreement leading to the formation of a customs union, to provide compensatory adjustment to its constituents.

Review of Customs Unions and Free Trade Areas

7. All notifications made under paragraph 7(a) of Article XXIV shall be examined by a working party in the light of the relevant provisions of GATT 1994 and of paragraph 1 of this Understanding. The working party shall submit a report to the Council for Trade in Goods on its findings in this regard. The Council for Trade in Goods may make such recommendations to Members as it deems appropriate.

8. In regard to interim agreements, the working party may in its report make appropriate recommendations on the proposed time-frame and on measures required to complete the formation of the customs union or free-trade area. It may if necessary provide for further review of the agreement.

9. Members parties to an interim agreement shall notify substantial changes in the plan and schedule included in that agreement to the Council for Trade in Goods and, if so requested, the Council shall examine the changes.

10. Should an interim agreement notified under paragraph 7(a) of Article XXIV not include a plan and schedule, contrary to paragraph 5(c) of Article XXIV, the working party shall in its report recommend such a plan and schedule. The parties shall not maintain or put into force, as the case may be, such agreement if they are not prepared to modify it in accordance with these recommendations. Provision shall be made for subsequent review of the implementation of the recommendations.

11. Customs unions and constituents of free-trade areas shall report periodically to the Council for Trade in Goods, as envisaged by the CONTRACTING PARTIES to GATT 1947 in their instruction to the GATT 1947 Council concerning reports on regional agreements (BISD 18S/38), on the operation of the relevant agreement. Any significant changes and/or developments in the agreements should be reported as they occur.

Dispute Settlement

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

(…)

* * *

General Agreement on Trade in Services (GATS) 1995

Article V

Economic Integration

1. This Agreement shall not prevent any of its Members from being a party to or entering into an agreement liberalizing trade in services between or among the parties to such an agreement, provided that such an agreement:

(*a*) has substantial sectoral coverage,[1] and

(*b*) provides for the absence or elimination of substantially all discrimination, in the sense of Article XVII, between or among the parties, in the sectors covered under subparagraph (a), through:

(*i*) elimination of existing discriminatory measures, and/or

(*ii*) prohibition of new or more discriminatory measures, either at the entry into force of that agreement or on the basis of a reasonable time-frame, except for measures permitted under Articles XI, XII, XIV and XIV bis.

2. In evaluating whether the conditions under paragraph 1(b) are met, consideration may be given to the relationship of the agreement to a wider process of economic integration or trade liberalization among the countries concerned.

3. (*a*) Where developing countries are parties to an agreement of the type referred to in paragraph 1, flexibility shall be provided for regarding the conditions set out in paragraph 1, particularly with reference to subparagraph (b) thereof, in accordance with the level of development of the countries concerned, both overall and in individual sectors and subsectors.

(*b*) Notwithstanding paragraph 6, in the case of an agreement of the type referred to in paragraph 1 involving only developing countries, more favourable treatment may be granted to juridical persons owned or controlled by natural persons of the parties to such an agreement.

4. Any agreement referred to in paragraph 1 shall be designed to facilitate trade between the parties to the agreement and shall not in respect of any Member outside the agreement raise the overall level of barriers to trade in services within the respective sectors or subsectors compared to the level applicable prior to such an agreement.

5. If, in the conclusion, enlargement or any significant modification of any agreement under paragraph 1, a Member intends to withdraw or modify a specific commitment inconsistently with the terms and conditions set out in its Schedule, it shall provide at least 90 days advance notice of such modification or withdrawal and the procedure set forth in paragraphs 2, 3 and 4 of Article XXI shall apply.

6. A service supplier of any other Member that is a juridical person constituted under the laws of a party to an agreement referred to in paragraph 1 shall be entitled to treatment granted

[1] (footnote original) This condition is understood in terms of number of sectors, volume of trade affected and modes of supply. In order to meet this condition, agreements should not provide for the a priori exclusion of any mode of supply.

under such agreement, provided that it engages in substantive business operations in the territory of the parties to such agreement.

7. (*a*) Members which are parties to any agreement referred to in paragraph 1 shall promptly notify any such agreement and any enlargement or any significant modification of that agreement to the Council for Trade in Services. They shall also make available to the Council such relevant information as may be requested by it. The Council may establish a working party to examine such an agreement or enlargement or modification of that agreement and to report to the Council on its consistency with this Article.

(*b*) Members which are parties to any agreement referred to in paragraph 1 which is implemented on the basis of a time-frame shall report periodically to the Council for Trade in Services on its implementation. The Council may establish a working party to examine such reports if it deems such a working party necessary.

(*c*) Based on the reports of the working parties referred to in subparagraphs (a) and (b), the Council may make recommendations to the parties as it deems appropriate.

8. A Member which is a party to any agreement referred to in paragraph 1 may not seek compensation for trade benefits that may accrue to any other Member from such agreement.

* * *

Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries (Decision of 28 November 1979 (L/4903)), also known as the "Enabling Clause":

1. Notwithstanding the provisions of Article I of the General Agreement, contracting parties may accord differential and more favourable treatment to developing countries[2], without according such treatment to other contracting parties.

2. The provisions of paragraph 1 apply to the following:

(…)

(*c*) Regional or global arrangements entered into amongst less-developed contracting parties for the mutual reduction or elimination of tariffs and, in accordance with criteria or conditions which may be prescribed by the CONTRACTING PARTIES, for the mutual reduction or elimination of non-tariff measures, on products imported from one another; (…)

[2]The words "developing countries" as used in this text are to be understood to refer also to developing territories.

1-3. Regional Trade Agreements

For information on regional trade agreements that have been notified to the WTO see http://www.wto.org/english/tratop_e/region_e/region_e.htm

For bilateral trade agreements of the United States and regional trade agreements to which the US are a party see:
http://www.ustr.gov/Trade_Agreements/Bilateral/Section_Index.html

http://www.ustr.gov/Trade_Agreements/Regional/Section_Index.html

1-4. Rules of Origin

WTO Secretariat Introduction to Rules of Origin: Technical Information

Available at http://www.wto.org/english/tratop_e/roi_e/roi_info_e.htm

Definition

Rules of origin are the criteria needed to determine the national source of a product. Their importance is derived from the fact that duties and restrictions in several cases depend upon the source of imports.

There is wide variation in the practice of governments with regard to the rules of origin. While the requirement of substantial transformation is universally recognized, some governments apply the criterion of change of tariff classification, others the ad valorem percentage criterion and yet others the criterion of manufacturing or processing operation. In a globalizing world it has become even more important that a degree of harmonization is achieved in these practices of Members in implementing such a requirement.

Where are rules of origin used?

Rules of origin are used:

— to implement measures and instruments of commercial policy such as anti-dumping duties and safeguard measures;

— to determine whether imported products shall receive most-favoured-nation (MFN) treatment or preferential treatment;

— for the purpose of trade statistics;

— for the application of labelling and marking requirements; and

— for government procurement.

No specific provision in GATT

GATT has no specific rules governing the determination of the country of origin of goods in international commerce. Each contracting party was free to determine its own origin rules, and could even maintain several different rules of origin depending on the purpose of the particular regulation. The draftsmen of the General Agreement stated that the rules of origin should be left:

> "...within the province of each importing country to determine, in accordance with the provisions of its law, for the purpose of applying the most-favoured-

nation provisions (and for other GATT purposes), whether goods do in fact originate in a particular country".

Article VIII:1(c) of the General Agreement, dealing with fees and formalities connected with importation and exportation, states that "the contracting parties also recognize the need for minimizing the incidence and complexity of import and export formalities and for decreasing and simplifying import and export documentation requirements" and the Interpretative Note 2 to this Article states that it would be consistent if, "on the importation of products from the territory of a contracting party into the territory of another contracting party, the production of certificates of origin should only be required to the extent that is strictly indispensable".

Interest in the harmonization of rules of origin

It is accepted by all countries that harmonization of rules of origin i.e., the definition of rules of origin that will be applied by all countries and that will be the same whatever the purpose for which they are applied - would facilitate the flow of international trade. In fact, misuse of rules of origin may transform them into a trade policy instrument *per se* instead of just acting as a device to support a trade policy instrument. Given the variety of rules of origin, however, such harmonization is a complex exercise.

In 1981, the GATT Secretariat prepared a note on rules of origin and, in November 1982, Ministers agreed to study the rules of origin used by GATT Contracting Parties. Not much more work was done on rules of origin until well into the Uruguay Round negotiations. In the late 1980s developments in three important areas served to focus more attention on the problems posed by rules of origin:

Increased number of preferential trading arrangements

First, an increased use of preferential trading arrangements, including regional arrangements, with their various rules of origin;

Increase in the number of origin disputes

Second, an increased number of origin disputes growing out of quota arrangements such as the Multifibre Arrangement and the "voluntary" steel export restraints; and

Increased use of anti-dumping laws

Lastly, an increased use of anti-dumping laws, and subsequent claims of circumvention of anti-dumping duties through the use of third country facilities.

The UR Agreement

Introduction

The increased number and importance of rules of origin led the Uruguay Round negotiators to tackle the issue during the negotiations.

Aims of the Agreement

Harmonization

The Agreement on Rules of Origin aims at harmonization of non-preferential rules of origin, and to ensure that such rules do not themselves create unnecessary obstacles to trade. The Agreement sets out a work programme for the harmonization of rules of origin to be undertaken after the entry into force of the World Trade Organization (WTO), in conjunction with the World Customs Organization (WCO).

General principles

Until the completion of the three-year harmonization work programme, Members are expected to ensure that their rules or origin are transparent; that they are administered in a consistent, uniform, impartial and reasonable manner; and that they are based on a positive standard.

Coverage: all non-preferential rules of origin

Article 1 of the Agreement defines rules of origin as those laws, regulations and administrative determinations of general application applied to determine the country of origin of goods except those related to the granting of tariff preferences. Thus, the Agreement covers only rules of origin used in non-preferential commercial policy instruments, such as MFN treatment, anti-dumping and countervailing duties, safeguard measures, origin marking requirements and any discriminatory quantitative restrictions or tariff quotas, as well as those used for trade statistics and government procurement. It is, however, provided that the determinations made for purposes of defining domestic industry or "like products of domestic industry" shall not be affected by the Agreement.

Institutions

WTO Committee on Rules of Origin

The Agreement establishes a Committee on Rules of Origin within the framework of the WTO, open to all WTO Members. It is to meet at least once a year and is to review the implementation and operation of the Agreements (Article 4:1).

WCO Technical Committee

A Technical Committee on Rules of Origin is created under the auspices of the World Customs Organization (formerly the Customs Cooperation Council). Its main functions are (a) to carry out the harmonization work; and (b) to deal with any matter concerning technical problems related to rules of origin. It is to meet at least once a year. Membership is open to all WTO Members; other WCO members and the WTO Secretariat may attend as observers (Article 4:2 and Annex I).

The Harmonization Work Programme (HWP)

Article 9:2 provided that the HWP be completed within three years of initiation. Its agreed deadline was July 1998. While substantial progress was made in that time in the implementation of the HWP, it could not be completed due to the complexity of issues. In July 1998 the General Council approved a decision whereby Members have committed themselves to make their best endeavours to complete the Programme by a new target date, November 1999.

The work is being conducted both in the WTO Committee on Rules of Origin (CRO) in Geneva and in the WCO Technical Committee (TCRO) in Brussels. The TCRO is to work, on a product-sector basis of the HS nomenclature, on the following matters:

Definitions of goods being wholly obtained

To provide harmonized definitions of the goods that are to be considered as being wholly obtained in one country, and of minimal operations or processes that do not by themselves confer origin to a good;

Last substantial transformation

Change of tariff heading

To elaborate, on the bases of the criteria of substantial transformation, the use of the change of tariff classification when developing harmonized rules of origin for particular products or sectors, including the minimum change within the nomenclature that meets this criterion.

Supplementary criteria

To elaborate supplementary criteria, on the basis of the criterion of substantial transformation, in a manner supplementary or exclusive of other requirements, such as ad valorem percentages (with the indication of its method of calculation) or processing operations (with the precise specification of the operation).

The CRO considers the input of the TCRO with the aim of endorsing the TCRO's interpretations and opinions, and, if necessary, refining or elaborating on the work of the TCRO and/or

developing new approaches. Upon completion of all the work in the TCRO, the CRO is to consider the results in terms of their overall coherence (Article 9:3).

Overall architectural design

The CRO and the TCRO have established an overall architectural design within which the harmonization work programme is to be finalized. This encompasses

— general rules, laid down in eight Articles provisionally entitled: Scope of Application; the Harmonized System; Definitions; Determination of Origin; Residual Rules of Origin; Minimal Operations or Processes; Special Provisions; and De Minimis;

— three Appendices:

Appendix 1: Wholly obtained goods;

Appendix 2: Product rules - substantial transformation; and

Appendix 3: Minimal operations or processes.

Results of the Harmonization Work Programme

The results of the harmonization programme are to be approved by the Ministerial Conference and will then become an annex to the Agreement. When doing this, the Ministerial Conference is also to give consideration to arrangements for the settlement of disputes relating to customs classification and to establish a time-frame for the entry into force of the new annex.

2. Turkey – Restrictions on Imports of Textile and Clothing Products (Turkey—Textiles)

For a long time it appeared impossible for a country to challenge another country's justification of GATT violations by recourse to Art. XXIV. The following dispute is one of the first in which the requirements of the Art. XXIV exception play a role in dispute settlement. Pay particular attention to the different legal approaches adopted by the panel and the Appellate Body (AB) to Art. XXIV.

When you read the panel and AB reports, it is important that you always analyse and understand the market. With respect to this case, ask yourself the following questions: Who asked the Indian government to bring the claim? What was at stake for the Complainants – in other words, what was the potential prize for India? Why did the European Communities insist that Turkey adopt quotas on textiles in the first place?

You should also always consider the strengths of the various legal arguments raised by the parties. Which was Turkey's strongest argument? Imagine that it is possible to appeal the AB report to an even higher tribunal – what could Turkey have colourably complained about in the AB report?

2-1. Editors' Case Summary

This case stems from an agreement between Turkey and the European Communities ("EC") to form a customs union (The EC was the predecessor to the European Union). As part of this agreement, the EC required Turkey to apply substantially the same commercial policy as the EC in a number of areas, which included certain temporary quantitative restrictions on 19 categories of textiles and clothing imports form India. Pursuant to this requirement, Turkey duly imposed these quantitative restrictions on India, and India initiated proceedings under the DSU. Turkey argued that its actions were justified under XXIV of GATT 1994, and India disagreed.

The panel found that these quantitative restrictions violated Articles XI and XIII of the GATT 1994, and Article 2.4 of the Agreement on Textiles and Clothing ("ATC"). Moreover, the Panel rejected Turkey's appeal to Article XXIV as a defense. On appeal, the AB affirmed the result but rejected some of the Panel's reasoning on Article XXIV.

2-2. Report of the Panel, WT/DS34R, 31 May 1999

Panelists: Armstrong, Wasecha and Human

Available at http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds34_e.htm

Editorial Note: The footnote numbering in this report does not necessarily correspond to the footnote numbering in the original.

I. INTRODUCTION

1.1 On 21 March 1996, India requested consultations with Turkey pursuant to Article 4.4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU") and Article XXIII:1 of the General Agreement on Tariffs and Trade 1994 ("GATT") regarding the unilateral imposition of quantitative restrictions ("QRs") by Turkey on imports of a broad range of textile and clothing products from India as from 1 January 1996 (WT/DS34/1).

1.2 India and Turkey did not enter into consultations, due to disagreement on the appropriateness of participation of the European Communities in such consultations, and consequently the dispute could not be resolved at that stage. The Dispute Settlement Body ("DSB") was informed accordingly on 24 April 1996.

(…)

II. FACTUAL ASPECTS

(…)

A. Regional Trade Agreements in the GATT/WTO Framework

2.2 The relationship between the most-favoured-nation ("MFN") principle and Article XXIV of the GATT, which deals with free-trade areas and customs unions, has not always been harmonious. In 1947, their coexistence in the framework of international trade relations had been viewed as ultimately positive, reflecting the perception that genuine customs unions and free-trade areas were congruent with the MFN principle and directed towards the same objective, i.e. multilaterally-agreed trade liberalization.[3]

2.3 As a matter of fact, trade liberalization under the GATT paralleled a process of increasing economic integration among contracting parties: from 1948 to end-1994, 107 regional trade agreements ("RTAs") were notified to the GATT under Article XXIV.[4]

2.4 … Article XXIV provisions confronted their first real applicability test with the notification of the Treaty of Rome in 1957, which concerned the integration of major players in the international scene. From then on, the examination of RTAs notified to the GATT did not lead to clear-cut assessments of full consistency with the rules, except in one instance.[5] Frictions between GATT contracting parties arising in the context of the formation of customs unions or free-trade areas were dealt with pragmatically.

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[3] Customs unions and free-trade areas were viewed as trade-creating instruments (susceptible to expand trade both among the parties and between these and third parties), but there were also concerns about their possible trade-distorting effects.

[4] Of these, only 36 remain today in force, reflecting in most cases the evolution over time of the RTAs themselves, as they were superseded by more modern agreements between the same signatories (usually going deeper in integration), or by their consolidation into wider groupings.

[5] This was the case of the Customs Union between the Czech Republic and the Slovak Republic (see *Working Party Report*, GATT document L/7501, dated 4 October 1994).

2.5 The perception that RTAs could contribute to the expansion of world trade was reiterated during the Uruguay Round, when negotiators re-visited certain aspects of Article XXIV, in an endeavour to clarify some of its provisions.[6]

2.6 During the course of the Uruguay Round, there was an increase in the number of new RTAs notified to the GATT. The conclusion of the Round and the establishment of the WTO did not put to rest the appeal of regional integration. Since 1 January 1995, a further 60 new RTAs have been notified under Article XXIV of GATT, most of which are presently in force.[7]

2.8 Later in 1996, the WTO Membership expressed its views on RTAs and the role of the CRTA [*WTO Committee on Regional Trade Agreements*] in paragraph 7 of the Singapore Ministerial Declaration, as follows:

> "We note that trade relations of WTO Members are being increasingly influenced by regional trade agreements, which have expanded vastly in number, scope and coverage. Such initiatives can promote further liberalization and may assist least-developed, developing and transition economies in integrating into the international trading system. In this context, we note the importance of existing regional arrangements involving developing and least-developed countries. The expansion and extent of regional trade agreements make it important to analyse whether the system of WTO rights and obligations as it relates to regional trade agreements needs to be further clarified. We reaffirm the primacy of the multilateral trading system, which includes a framework for the development of regional trade agreements, and we renew our commitment to ensure that regional trade agreements are complementary to it and consistent with its rules. In this regard, we welcome the establishment and endorse the work of the new Committee on Regional Trade Agreements. …"[8]

(…)

B. Turkey's Trade Relations with the European Communities

1. Association between Turkey and the European Communities, and the GATT/WTO process[9]

2.10 On 12 September 1963, Turkey and the Council and member States of the then European Economic Community ("EEC") signed the *Ankara Agreement*,[10] which entered into force on 1 December 1964. The Ankara Agreement formed the basis of the Association … between Turkey and the European Communities envisaging that its objectives would be reached through a customs union which would be established in three progressive stages: preparatory, transitional and final. Article 28 of the Ankara Agreement also left open "the possibility of the accession" of

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[6] The result of such negotiations is embodied in the Understanding on the Interpretation of Article XXIV of GATT 1994.

[7] The negotiation of RTAs among countries geographically distant has also become an increasingly frequent feature in the 1990s.

[8] WT/MIN(96)/DEC, para. 7.

[9] The official titles of the agreements have changed over time. The European Communities is a WTO Member.

[10] GATT document L/2155/Add.1.

Turkey to the EEC. The Ankara Agreement itself contained the modalities of the preparatory stage of the Association.

(…)

2.13 Starting in 1973, Turkey embarked in the gradual alignment of its customs duties to the EC Common Customs Tariff ("CCT"), as scheduled. The implementation of Turkey's obligations arising out of its Association with the European Communities was interrupted during a number of years, due *inter alia* to the crisis in which the Turkish economy was engulfed following the oil shocks of 1973 and 1979. In 1987, when Turkey requested accession to the European Communities, completion of the customs union was seen as part of a package of measures designed to help Turkey prepare for membership. In 1988, Turkey resumed the reduction of its customs duties and alignment on the CCT.

2.14 The Ankara Agreement and the subsequent instruments concluded in the context of the Association between Turkey and the European Communities during the 1970s were notified to the GATT Contracting Parties under Article XXIV:7 of GATT 1947. …

2.15 As agreed at a meeting of the Turkey-EC Association Council ("Association Council") held in November 1992,[11] negotiations were initiated between the two parties on the modalities for the completion of the customs union, i.e. for the final phase of the Association. These negotiations were conducted from 1993 to 1995.

2.16 On 6 March 1995, the Association Council took *Decision 1/95*, to enter into force on 1 January 1996.[12] Decision 1/95 set out the modalities for the final phase of the Association between Turkey and the European Communities. In addition to the elimination of customs duties and alignment on the CCT, it contained provisions for the harmonisation of Turkey's policies and practices in all areas covered by the Association where this was deemed necessary "for the proper functioning of the Customs Union". …

(…)

C. Quantitative Limits in Respect of Turkey's Imports of Certain Textile and Clothing Products

1. Historical background

2.25 The gradual removal of QRs in major developed countries during the 1950s, in the wake of general liberalization efforts pursued in the GATT, brought about substantial increases in textiles and clothing imports into major developed countries originating in low-cost countries. To alleviate the difficulties caused to their producers, some importing countries convinced exporters of cotton textiles to conclude voluntary export restraint agreements. In an attempt to find a multilateral solution to the problem, in 1960 the GATT CONTRACTING PARTIES recognized the phenomenon of market disruption, thus setting the ground for selective safeguard action in the

[11] The Association Council was created by the Ankara Agreement, as the only decision-making body of the Turkey-EC Association.
[12] Decision 1/95 is reproduced in WT/REG22/1.

area of textile and clothing products (as a departure from the requirements of Article XIX of GATT 1947).

2.26 Thereafter, discriminatory restraints took the form of the 1961 Short-Term Arrangement Regarding International Trade in Cotton Textiles, followed in 1962 by the Long-Term Cotton Textiles Arrangement (1962-1973). The Arrangement Regarding International Trade in Textiles or Multifibre Arrangement ("MFA") entered into force in 1974, extending the coverage of the restrictions on textiles and clothing from cotton products, to include wool and man-made fibre products (and, from 1986, certain vegetable fibre products).[13]

2.27 During its 21 years of existence, from 1974 to 1994, the MFA underwent numerous operational changes and adaptations. The restraints under the MFA developed into a complex network of restrictions, bilaterally negotiated (or imposed in the case of unilateral actions) at short intervals, often every year or so. In the last year of its existence, the MFA had 44 participants, six of which (Canada, Norway, the United States and the European Communities, *plus* Austria and Finland,) applied restraints. Such restraints were used almost exclusively to protect their markets against imports of textiles and clothing from developing countries and, to a lesser extent, from former state-trading countries, also MFA members.

2.28 After more than three decades of special and increasingly complicated regimes governing international trade in textile and clothing products, seven years of negotiations during the Uruguay Round resulted in the ATC. Through the transitional process embodied in the ATC, by 1 January 2005 the extensive and complex system of bilateral restraints will come to an end and importing countries will no longer be able to discriminate between exporters in applying safeguard measures.

2.29 Turkey became a member of the MFA, as an exporting country, in 1981. Since 1979, Turkish textile and clothing products were subjected to restraints in the EC market under the provisions of Article 60 of the Additional Protocol to the Ankara Agreement.[14]

2.30 On 31 December 1994, one day before the ATC came into force, Turkey did not maintain QRs on imports of textile and clothing products. Its exports of certain textile and clothing products were at that time under restraint in the European Communities and other countries' markets under the MFA.

2. Recent background

2.31 In accordance with Article 13 of Decision 1/95, as of 1 January 1996, the customs duties applied by Turkey to the industrial goods imported from third countries were harmonized with the CCT and the previous Mass Housing Fund levy of some 20 per cent, collected from industrial goods, was abolished. With respect to imports of textile and clothing products, the MFN tariffs

[13] Operationally, the MFA (like the cotton arrangements) provided rules for the imposition of restraints, either through bilateral agreements or, in cases of market disruption or threat thereof, through unilateral action. Importing countries were also required, with certain exceptions, to allow for an annual growth rate in the restraints.

[14] Notified to the Textiles Surveillance Body under Article 7 of the MFA.

applied by Turkey were thereby reduced from roughly 10 per cent for textiles and 14 per cent for clothing in 1994 (*plus* the Mass Housing Fund levy) to 9 per cent in 1996.[15]

(…)

2.34 Early in 1995, in its endeavour to complete Decision 1/95 requirements for the "completion of the Customs Union", Turkey sent proposals to the relevant countries (i.e. those whose imports of textiles and clothing were under restraint in the EC market), including India, to reach agreements for the management and distribution of quotas under a double checking system. A standard formula was proposed for calculating the levels of QRs on textile and clothing products to be introduced by Turkey vis-à-vis all third countries concerned.

2.35 On 31 July 1995, Turkey forwarded to the Indian authorities a draft Memorandum of Understanding on trade in the categories of textile and clothing products on which Turkey intended to introduce QRs. India was invited to enter into negotiations with Turkey, with the participation of the European Communities, to conclude, prior to the completion of the Customs Union, an arrangement covering trade in those products which would be similar to the one already existing between India and the European Communities. India maintained that the intended restrictions were in contravention of Turkey's multilateral obligations and declined to enter into discussions on the conditions proposed by Turkey.

2.36 … As from 1 January 1996, unilateral restrictions or surveillance regimes were applied to imports originating in another 28 countries (WTO Members and non-Members), including India, with which Turkey could not reach agreement. These restrictions only affected products whose export to the European Communities was also under restraint.

(…)

IX. FINDINGS

(…)

F. Claims under Articles XI and XIII of GATT and Article 2.4 of the ATC

9.60 India claims that the Turkish measures violate the provisions of Articles XI and XIII of GATT and Article 2.4 of the ATC. Turkey claims that its rights pursuant to Article XXIV of GATT prevail over any obligations contained in Articles XI and XIII of GATT and Article 2.4 of the ATC, and therefore India's claims should be rejected.

[15] The average level of protection of those imports in Turkey was 37 per cent in 1993.

1. Articles XI and XIII of GATT

9.61 The wording of Articles XI and XIII is clear. Article XI provides that as a general rule (we note the wording of the title of Article XI: "*General Elimination* of Quantitative Restrictions"), WTO Members shall not use quantitative restrictions against imports or exports.

> "Article XI
>
> *General Elimination of Quantitative Restrictions*
>
> 1. No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences or other measures, shall be instituted or maintained by any Member on the importation of any product of the territory of any other Member or on the exportation or sale for export of any product destined for the territory of any other Member."

9.62 Article XIII provides that if and when quantitative restrictions are allowed by the GATT/WTO, they must, in addition, be imposed on a non-discriminatory basis.

> "Article XIII
>
> *Non-discriminatory Administration of Quantitative Restrictions*
>
> 1. No prohibition or restriction shall be applied by any Member on the importation of any product of the territory of any other Member or on the exportation of any product destined for the territory of any other Member, unless the importation of the like product of all third countries or the exportation of the like product to all third countries is similarly prohibited or restricted."

9.63 The prohibition on the use of quantitative restrictions forms one of the cornerstones of the GATT system. A basic principle of the GATT system is that tariffs are the preferred and acceptable form of protection. Tariffs, to be reduced through reciprocal concessions, ought to be applied in a non-discriminatory manner independent of the origin of the goods (the "most-favoured-nation" (MFN) clause). Article I, which requires MFN treatment, and Article II, which specifies that tariffs must not exceed bound rates, constitute Part I of GATT. Part II contains other related obligations, *inter alia* to ensure that Members do not evade the obligations of Part I. Two fundamental obligations contained in Part II are the national treatment clause and the prohibition against quantitative restrictions. The prohibition against quantitative restrictions is a reflection that tariffs are GATT's border protection "of choice". Quantitative restrictions impose absolute limits on imports, while tariffs do not. In contrast to MFN tariffs which permit the most efficient competitor to supply imports, quantitative restrictions usually have a trade distorting effect, their allocation can be problematic and their administration may not be transparent.

9.64 Notwithstanding this broad prohibition against quantitative restrictions, GATT contracting parties over many years failed to respect completely this obligation. From early in the GATT, in sectors such as agriculture, quantitative restrictions were maintained and even increased to the extent that the need to restrict their use became central to the Uruguay Round

negotiations. In the sector of textiles and clothing, quantitative restrictions were maintained under the Multifibre Agreement …

9.65 Participants in the Uruguay Round recognized the overall detrimental effects of non-tariff border restrictions (whether applied to imports or exports) and the need to favour more transparent price-based, i.e. tariff-based, measures; to this end they devised mechanisms to phase-out quantitative restrictions in the sectors of agriculture and textiles and clothing. This recognition is reflected in the GATT 1994 Understanding on Balance-of-Payments Provisions[16], the Agreement on Safeguards[17], the Agreement on Agriculture where quantitative restrictions were eliminated[18] and the Agreement on Textiles and Clothing (further discussed below) where MFA derived restrictions are to be completely eliminated by 2005.

9.66 The measures at issue, on their face, impose quantitative restrictions on imports and are applicable only to India.[19] We consider that, given the absence of a defense by Turkey (other than its defense based on Article XXIV of GATT) to India's claims that discriminatory import restrictions have been imposed, India has made a *prima facie* case of violation of Articles XI[20] and XIII of GATT.

(…)

9.86 Consequently, unless the measures under examination are justified by Article XXIV (Turkey's defense that we examine below) they are inconsistent with the provisions of Articles XI and XIII of GATT and they would necessarily violate also Article 2.4 of the ATC.

G. Turkey's Defense Based on Article XXIV of GATT

9.87 We shall now proceed to examine Turkey's defense based on the application of Article XXIV and determine whether it rebuts what appears to be *prima facie* evidence of violations of Articles XI and XIII of GATT and Article 2.4 of the ATC.

9.88 Turkey argues that the measures at issue do not violate Articles XI and XIII of GATT or Article 2.4 of the ATC because they were implemented in relation to the formation of its customs union with the European Communities, which it considers to be compatible with the provisions of Article XXIV of GATT. For Turkey, the provisions of Article XXIV are concerned with the

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[16] See for instance paras. 2 and 3 of the GATT 1994 Understanding on the Balance-of-Payments Provisions which provide that Members shall seek to avoid the imposition of new quantitative restrictions for balance-of-payments purposes.

[17] The Agreement on Safeguards also evidences a preference for the use of tariffs. Article 6 provides that provisional safeguard measures "should take the form of tariff increases" and Article 11 prohibits the use of voluntary export restraints.

[18] Under the Agreement on Agriculture, notwithstanding the fact that contracting parties, for over 48 years, had been relying a great deal on import restrictions and other non-tariff measures, the use of quantitative restrictions and other non-tariff measures was prohibited and Members had to proceed to a "tariffication" exercise to transform quantitative restrictions into tariff based measures.

[19] We note, however, that Turkey maintains other quantitative restrictions against textiles and clothing imports from other countries on the same and/or other products; see para. 6.12 above. See also WT/REG22/7.

[20] We note that the measures at issue do not qualify for any of the exceptions under Article XI of GATT.

scope of application of GATT, both generally and in particular circumstances. As such, Article XXIV should not be regarded as a "justification", a "defense", an "exception" or a "waiver". In Turkey's view, the special nature of Article XXIV is evidenced by the fact that Article XXIV is in Part III of GATT, and not in Part II together with other provisions on commercial policies. For Turkey, Article XXIV, paragraphs 5 to 9, is to be viewed as *lex specialis* for the rights and obligations of WTO Members at the time of formation of a regional trade agreement. In other words, in Turkey's view, the WTO consistency of the measures challenged by India depends on the WTO consistency of the Turkey-EC customs union (of which they are an integral part) and the WTO consistency of both the customs union and its measures is to be determined with reference to the provisions of paragraphs 5 to 9 of Article XXIV only and no other GATT provisions.

9.89 India considers that all GATT rules define the limits of applicability of the GATT. India is of the view that, if Turkey's argument were accepted, Members forming a customs union could legally circumvent the WTO procedural and substantive requirements with respect to quantitative restrictions, which the signatories of the WTO agreements agreed to permit only in exceptional circumstances. In respect of such Members, the WTO agreements could no longer operate as a legal framework providing effective assurances of market access and the WTO dispute settlement procedures would be rendered ineffective.

9.90 In order to analyze Turkey's arguments, which we consider are properly labelled a defense[21] to India's claims, we firstly recall certain basic interpretative principles applicable in WTO dispute settlement proceedings. Secondly, we examine the provisions of Article XXIV generally. Thirdly, we consider the meaning of Article XXIV:5 and, finally that of Article XXIV:8, which constitute the heart of Turkey's defense to India's claims.

1. General Interpretative Principles

(a) Vienna Convention on the Law of Treaties

9.91 In its examination of Article XXIV, the Panel is guided by the principles of interpretation of public international law (Article 3.2 of the DSU) which include Articles 31 and 32 of the Vienna Convention on the Law of Treaties (VCLT). As provided for in these articles and as applied by panels and the Appellate Body, we interpret the provisions of Article XXIV using first the ordinary meaning of the terms of that provision, as elaborated upon by the 1994 Understanding on Article XXIV, in their context and in light of the object and purpose of the relevant WTO agreements. If need be, to clarify or confirm the meaning of these provisions, we may refer to the negotiating history, including the historical circumstances that led to the drafting of Article XXIV of GATT. We note also the prescription of Article XVI:1 of the WTO Agreement which provides that "… the WTO shall be guided by the decisions, procedures and customary practices followed by CONTRACTING PARTIES to GATT 1947 and the bodies established in the framework of GATT 1947".[22]

[21] We note, from our research, that during the negotiation of Article XXIV, participants typically referred to Article XXIV as an "exception" for customs unions and free-trade areas. See also footnote 287 above.
[22] See Appellate Body Report on *Japan – Alcoholic Beverages*, p. 14.

(b) WTO rules on conflicts

9.92 As a general principle, WTO obligations are cumulative and Members must comply with all of them at all times unless there is a formal "conflict" between them. This flows from the fact that the WTO Agreement is a "Single Undertaking".[23] On the definition of conflict, it should be noted that:

> "… a conflict of law-making treaties arises only where simultaneous compliance with the obligations of different instruments is impossible. ... There is no conflict if the obligations of one instrument are stricter than, but not incompatible with, those of another, or if it is possible to comply with the obligations of one instrument by refraining from exercising a privilege or discretion accorded by another."[24]

(…)

9.95 In light of this general principle, we will consider whether Article XXIV authorizes measures which Articles XI and XIII of GATT and Article 2.4 of the ATC otherwise prohibit. In view of the presumption against conflicts, as recognized by panels and the Appellate Body, we bear in mind that to the extent possible, any interpretation of these provisions that would lead to a conflict between them should be avoided.

(c) Principle of effective interpretation

9.96 Finally we would also like to recall the principle of effective interpretation[25] whereby all provisions of a treaty must be, to the extent possible, given their full meaning so that parties to such a treaty can enforce their rights and obligations effectively. …

2. Overview of Article XXIV of GATT

9.97 In examining of Article XXIV, we are well aware that regional trade agreements have greatly increased in number and importance since the establishment of GATT 1947 and today

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[23] See the Appellate Body statement in *Brazil – Desiccated Coconut*, page 12. The WTO is a single undertaking except for the plurilateral agreements for the non-signatories.

[24] Wilfred Jenks, "The Conflict of Law-Making Treaties", The British Yearbook of International Law (1953) at p. 426-427.

[25] The principle of effective interpretation or "l'effet utile" or in latin *ut res magis valeat quam pereat* reflects the general rule of interpretation which requires that a treaty be interpreted to give meaning and effect to all the terms of the treaty. For instance one provision should not be given an interpretation that will result in nullifying the effect of another provision of the same treaty. For a discussion of this principle see also the Yearbook of the International Law Commission, 1966, Vol II A/CN.4/SER.A/1966/Add.1 p. 219 and following. See also *E.g., Corfu Channel* Case, (1949) I.C.J. Reports, p. 24; *Territorial Dispute* Case (Libyan Arab Jamahiriya v. Chad), (1994) I.C.J. Reports, p. 23; Oppenheim's International Law (9th ed., Jennings and Watts eds., 1992), Volume 1, 1280-1281; P. Dallier and A. Pellet, Droit International Public, 5è éd. (1994) para. 17.2; D. Carreau, Droit International (1994), para. 369.

cover a significant proportion of world trade. We have also undertaken a detailed analysis of the negotiating history of Article XXIV. We note that the wording of Article XXIV is of sub-optimal clarity and has been the object of various, sometimes opposing, views among individual contracting parties and Members and in the literature. We are also aware that the economic and political realities that prevailed when Article XXIV was drafted, have evolved and that the scope of regional trade agreements is now much broader than it was in 1948. Pursuant to the Vienna Convention on the Law of Treaties, we begin our analysis of the terms of Article XXIV together with those of GATT 1947, GATT 1994, the 1994 Understanding on Article XXIV in their context and in the light of the object and purpose of the WTO Agreement, GATT, the ATC and the relevant provisions on regional trade agreements.

9.98 As a means of increasing freedom of trade, Article XXIV recognizes that, subject to certain conditions, customs unions and free-trade areas between WTO Members are desirable. To this end Article XXIV provides for the possibility that Members forming a customs union may depart, as to the trade between themselves, from the most-favoured nation principle, in conformity with the conditions of Article XXIV.[26] There are a number of indications of the broad desirability of Article XXIV agreements as a means of increasing freedom of trade. For example, paragraph 4 of Article XXIV provides that:

> "The Members recognize the desirability of increasing freedom of trade by the development, through voluntary agreements, of closer integration between economies of the countries parties to such agreements."

9.99 Similarly, the preamble of the GATT 1994 Understanding on Article XXIV, which was added to GATT 1994 as a result of the Uruguay Round, reiterates that:

> "such contribution to the expansion of world trade may be made by closer integration between the economies of the parties to such agreements".

(…)

9.101 This recognition of the desirability of regional trade agreements is not without qualification, however. Article XXIV:4 appears also to recognize that some of these agreements may have detrimental effects and therefore the rest of paragraph 4 of Article XXIV provides:

> "They also recognize that the purpose of a customs union and a free-trade area should be to facilitate trade between constituent territories *and not to raise barriers to the trade of other Members with such territories*." (emphasis added)

9.102 This is reiterated in the preamble of the GATT 1994 Understanding on Article XXIV which provides that:

> *"Reaffirming* that the purpose of such agreements should be to facilitate trade between the constituent territories and *not to raise barriers to the trade of other Members with such territories*; and that in their formation or enlargement the parties

[26] We note in this context the statement of the Appellate Body in *EC - Bananas III*, para. 191: "Non-discrimination obligations apply to all imports of like products, except when these obligations are specifically waived or are otherwise not applicable as a result of the operation of specific provisions of the GATT 1994, such as Article XXIV".

to them should to the greatest possible extent avoid creating adverse effects on the trade of other Members;" (emphasis added)

9.103 The terms of Article XXIV thus confirm that WTO Members have a right, albeit conditional, to conclude regional trade agreements.

9.104 In this regard, Article XXIV:5 provides that:

"Accordingly, the provisions of this Agreement [GATT 1994] shall not prevent, as between the territories of Members, the formation of a customs union or of a free-trade area or the adoption of an interim agreement necessary for the formation of a customs union or of a free-trade area; *Provided* that … :"

(…)

9.106 With the intent of enabling Members as a whole to monitor the formation of such regional trade agreements, Article XXIV:7 provides that:

"(*a*) Any Member deciding to enter into a customs union or free-trade area, or an interim agreement leading to the formation of such a union or area, shall promptly notify the Members and shall make available to them such information regarding the *proposed* union or area as will enable them to make such reports and recommendations to Members as they may deem appropriate." (emphasis added)

Paragraph 7 of the GATT 1994 Understanding on Article XXIV provides that:

"Review of Customs Unions and Free-Trade Areas

7. All notifications made under paragraph 7(a) of Article XXIV shall be examined by a working party in the light of the relevant provisions of GATT 1994 and of paragraph 1 of this Understanding. The working party shall submit a report to the Council for Trade in Goods on its findings in this regard. The Council for Trade in Goods may make such recommendations to Members as it deems appropriate."

9.107 Traditionally in GATT, regional trade agreements were examined by working parties. In the WTO, such agreements are now examined by the Committee on Regional Trade Agreements (CRTA). In the history of GATT, except in the case of the 1994 customs union between the Czech Republic and the Slovak Republic, the CONTRACTING PARTIES were never able to conclude whether or not a regional trade agreement was fully compatible with GATT. Today, under the WTO, Members have yet to conclude that a regional trade agreement is in full compliance with the WTO Agreement. In short, virtually all working party reports on regional trade agreements have been inconclusive.

(…)

3. Article XXIV:5(a)

(a) Arguments of the parties

9.109 Turkey claims that Article XXIV:5 of GATT 1994 authorizes the formation of a customs union, as defined by Article XXIV:8(a), provided that the conditions of Article XXIV:5(a) are met. Turkey argues that the provisions of Article XXIV:5(a) should be read as permitting, at the time of the completion of a customs union, the introduction of restrictive regulations of commerce to the trade of third countries, provided that the overall incidence of duties and other regulations of commerce was not higher or more restrictive after the completion of the customs union than before. Turkey claims that the overall incidence of duties and other regulations of commerce of the constituent members of the Turkey-EC customs union is not higher or more restrictive after the completion of the customs union than before.

9.110 In Turkey's view, the fact that Article XXIV does not prohibit Members from introducing new restrictions is confirmed in the last sentence of paragraph 2 of the GATT 1994 Understanding on Article XXIV, which states, *inter alia*, that:

> "for the purposes of the overall assessment of the incidence of other regulations of commerce for which quantification and aggregation are difficult, the examination of individual measures, regulations, products covered and trade flows affected may be required".

9.111 For Turkey, if it had been the intention of Members to ban the imposition of new quantitative restrictions whenever a customs union was being instituted, the reference to "other regulations of commerce" in Article XXIV:5 would have been a redundant provision.

9.112 Turkey further argues that the derogation envisaged by Article XXIV:5 is not limited to a particular GATT rule, but encompasses all those rules from which a derogation is necessary to permit the formation of customs unions. In support of this argument, Turkey notes that the opening clause of Article XXIV:5 is drafted in language similar to the language used in the opening clause of Article XX: "the provisions of this Agreement shall not prevent the formation of customs unions provided that …". For Turkey, this wording demonstrates that the derogation refers to all the provisions of the GATT, and not just to those contained in Article II, which are more specifically mentioned in Article XXIV:6.

9.113 For India, the terms of Article XXIV:5 do not provide a legal basis for measures otherwise incompatible with GATT/WTO rules. This provision merely authorizes the formation of a customs union or free-trade area, nothing else. Its terms consequently exempt from the other obligations under the GATT only measures inherent in the formation of a customs union or a free-trade area. For instance, a customs union or a free-trade area could only be formed by the granting of preferential treatment inconsistent with Article I and Article XXIV clearly provides a justification therefor. However, customs unions and free-trade areas could be formed without the introduction of new quantitative restrictions on imports from third Members inconsistent with Article XI of GATT. There is, in particular, nothing that requires Members forming a customs union to impose new restrictions on imports from one particular third Member, inconsistently with Articles XI and XIII of GATT and Article 2.4 of the ATC.

9.114 India also refers the Panel to Article XXIV:6, as part of the context of paragraph 5, which recognizes that on the occasion of the creation of a customs union, tariff bindings may be increased. India argues that there is no corresponding mechanism for renegotiation and compensation for Members affected by the introduction or increase of quantitative restrictions which are otherwise WTO incompatible. For India, this is a logical consequence of the principle that increasing tariffs is not as such WTO incompatible, as tariffs are negotiable (and renegotiable under Article XXVIII), whereas quantitative restrictions are in general prohibited and may only be imposed in circumstances narrowly defined in the WTO agreements. Given that rules governing quantitative restrictions are fundamentally different from the rules governing tariffs, there is no basis to apply Article XXIV:6 by analogy to quantitative restrictions. …

(…)

(b) Analysis of Article XXIV:5(a)

(i) Ordinary meaning of the terms of Article XXIV:5(a)

9.116 Article XXIV:5(a) provides as follows:

> "5. Accordingly, *the provisions of this Agreement shall not prevent*, as between the territories of contracting parties, *the formation of a customs union* or of a free-trade area or the adoption of an interim agreement necessary for the formation of a customs union or of a free-trade area; *Provided* that:
>
> (*a*) with respect to a customs union, or an interim agreement leading to a formation of a customs union, the duties and other regulations of commerce imposed at the institution of any such union or interim agreement in respect of trade with contracting parties not parties to such union or agreement shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such union or the adoption of such interim agreement, as the case may be;" (emphasis added)

9.117 With respect to tariffs, paragraph 2 of the GATT 1994 Understanding on Article XXIV makes it clear that it is the level of the "applied duties" that are to be taken into account by Members in their "evaluation under paragraph 5(a) of Article XXIV":

> "For this purpose the duties and charges to be taken into consideration shall be the applied rates".

9.118 By requiring an examination of changes in applied duties, the provisions of Article XXIV:5(a) are made unambiguously distinct from those in Article XXIV:6, since the level of applied duties, unlike bound tariffs, is not regulated in the WTO framework of rights and obligations. Since the analysis of applied duties is a basic tool in appraising the impact of actual border barriers on trade opportunities, we consider that the requirement of an overall assessment of the incidence of duties based on applied duties clearly points at the economic nature of the assessment under paragraph 5(a).

9.119 The same conclusion is applicable in relation to the overall assessment of the incidence of other (non-tariff) regulations of commerce, in respect of which paragraph 2 of the Understanding on Article XXIV provides:

> "… It is recognized that for the purpose of the overall assessment of the incidence of other regulations of commerce for which quantification and aggregation are difficult, the examination of individual measures, regulations, products covered and trade flows affected may be required."

9.120 Thus, the terms of paragraph 5(a) of Article XXIV, as elaborated upon and clarified by the GATT 1994 Understanding on Article XXIV, provide for an "economic" test for assessing whether a specific customs union is compatible with Article XXIV. In the context of the overall assessment of the potential trade impact of any such customs union, (a task envisaged to be performed by the WTO membership through the CRTA[27]), duties and all regulations which existed in one or more of the constituent members and/or form part of the customs union treaty must be taken into account. While there is no agreed definition between Members as to the scope of this concept of "other regulations of commerce", for our purposes, it is clear that this concept includes quantitative restrictions. More broadly, the ordinary meaning of the terms "other regulations of commerce" could be understood to include any regulation having an impact on trade (such as measures in the fields covered by WTO rules, e.g. sanitary and phytosanitary, customs valuation, anti-dumping, technical barriers to trade; as well as any other trade-related domestic regulation, e.g. environmental standards, export credit schemes). Given the dynamic nature of regional trade agreements, we consider that this is an evolving concept.

9.121 We note that the language of paragraph 5(a) of Article XXIV is general and not prescriptive. While it authorizes the formation of customs unions, it does not contain any provision that either authorizes or prohibits, on the occasion of the formation of a customs union, the adoption of import restrictions otherwise GATT/WTO incompatible, by any of the parties forming this customs union. For example, the terms of paragraph 5(a) do not permit or prohibit or otherwise regulate increases of bound tariffs, which is an issue dealt with in paragraph 6 of Article XXIV. Rather, paragraph 5(a) provides for an economic assessment (to be performed by the WTO membership as a whole) of the overall effect of the applied tariffs and other regulations of commerce resulting from the formation of the customs union.[28] While the wording of paragraph 5(a) assumes that, as a result of a customs union, some (applied) duties may be higher, and/or other regulations of commerce may be more restrictive than before, it does not specify whether such a situation may occur only through GATT/WTO consistent actions or may occur through GATT/WTO inconsistent actions. What paragraph 5(a) provides, in short, is that the effects of the resulting trade measures and policies of the new regional agreement shall not be more trade restrictive, overall, than were the constituent countries' previous trade policies.

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[27] In this respect we note the standard terms of reference used by the Council for Goods for examining regional trade agreements, as set out in WT/REG3/1.

[28] The assessment, with respect to applied tariffs, is based on two comparable trade-weighted averages of applied tariffs, calculated by the Secretariat in accordance with the methodology described in paragraph 2 of the Understanding: (a) an average representing the pre-customs union situation; and (b) another average reflecting the situation just after the formation of the customs union. To compute the figure under (a), all applied tariffs (by tariff line) of all parties to the customs union are averaged using - as weights - the corresponding values of their imports from non-preferential origins; the figure under (b) is obtained by averaging the tariffs (to be) applied by the customs union, using the same values as trade weights.

9.122 In other words, we consider that the terms of paragraph 5(a) do not address the GATT/WTO compatibility of specific measures that may be adopted on the occasion of the formation of a new customs union. We note that the standard terms of reference used by the CRTA for the examination of regional trade agreements confirm that the CRTA, in its overall assessment, shall not determine the WTO compatibility of specific measures. The terms of Article XXIV:5(a) only provide that, for a customs union to be compatible with Article XXIV of GATT and the 1994 GATT Understanding on Article XXIV, the overall impact of the applied tariffs and other regulations of commerce resulting from the formation of the customs union must not be more restrictive than that of its constituent members prior to its formation.

9.123 It is important to emphasize that this interpretation does not render paragraph 5(a) a nullity, as suggested by Turkey. In terms of our reading of paragraph 5(a), it continues to play an important role in ensuring that the occasion of the formation of a customs union is not used to increase trade barriers overall, even if the parties' previous concessions allowed such an increase (e.g., in the case of increased applied rates below tariff levels bound by all parties). Indeed, that purpose is in fact emphasized by the focus on "applied", and not on bound, tariff rates.

(ii) The immediate context of Article XXIV:5(a)

9.124 Our interpretation of the terms of Article XXIV:5(a) is supported by their context. That context in the first place consists of the other provisions of Article XXIV relating to regional trade agreements.

Article XXIV:5(b)

9.125 Our interpretation of paragraph 5(a) is also supported by the similar wording contained in paragraph 5(b) in relation to free-trade areas. In paragraph 5(b), which is concerned with free-trade areas, it is stated that "… the duties and other regulations of commerce maintained in *each* of the constituent territories … shall not be higher or more restrictive than the corresponding duties and other regulations of commerce existing in the same constituent territories …" (emphasis added). We note that the terms of paragraph 5(b) are very similar to those in paragraph 5(a). In free-trade areas, however, constituent members are not required to harmonize their other trade regulations with third countries. Therefore, constituent members of a free-trade area could not argue that the terms of paragraph 5(b) would authorize them to violate other provisions of the WTO Agreement in their efforts to harmonize their external trade policies, since they are not required to do so. Consequently, we see no basis for arguing that the terms of paragraph 5(a) authorize constituent members of a customs union to adopt GATT-inconsistent measures. The same terms being used in paragraphs 5(a) and 5(b) should not lead to different interpretations.

Article XXIV:4

9.126 We also note that Article XXIV:4 provides that the purpose of a customs union should not be to raise barriers to the trade of other Members. While not expressed as an obligation, paragraph 4 (and its elaboration in the fifth paragraph of the Preamble of the GATT 1994 Understanding on Article XXIV) argues against an interpretation of paragraph 5(a) that would read into that paragraph an exception to GATT rules that prohibit specific trade barriers. This view is also expressed by Japan and Hong Kong, China in their third party submissions. With the use of the term "Accordingly", the language of paragraph 4 is specially relevant to the application and interpretation

of the provisions in paragraph 5, and argues against any interpretation in favour of exceptions or deviations (not elsewhere foreseen) to the general GATT prohibition against the use of quantitative restrictions. This is also noted by the Philippines.

Article XXIV:6

9.127 Furthermore, Article XXIV:6 provides that if a Member "proposes to increase any rate of duty inconsistently with the provisions of Article II, the procedure set forth in Article XXVIII shall apply". Thus, in the adoption of the common external tariff of a customs union, compensation is due if a pre-existing tariff binding is exceeded. We note that there is no parallel provision to compensate Members for the introduction of quantitative restrictions. In our view, this is the case because quantitative restrictions are generally prohibited by GATT/WTO, while increases of tariffs above their bindings, if re-negotiated, are WTO compatible.

9.128 We also consider that this reference to Article XXVIII in Article XXIV provides evidence of the application of the other GATT provisions to measures adopted on the occasion of the formation of a customs union. The purpose of such specific reference to Article XXVIII, is to allow for the re-negotiation of the tariff bindings outside the time and prior notification constraints of Article XXVIII (including Article XXVIII*bis* and the GATT 1994 Understanding on Article XXVIII).

(…)

Article XXIV in Part III of GATT

9.130 An additional element relating to the context is the fact that Article XXIV is found in Part III of GATT, a section of GATT distinct from Part I and Part II. Part I contains the main foundations of GATT: the most-favoured nation clause (Article I) and the tariff commitments or bindings (Article II). Part II contains a set of disciplines, the purpose of which is mainly to ensure the effectiveness of the tariff commitments. This is evident from the prohibition against quantitative restrictions (Article XI) and the national treatment obligation (Article III). We note that Article XXIV is not listed with the general exceptions (Article XX) or the security exception (Article XXI), both of which are in Part II.

(…)

(iii) Conclusion based on the ordinary meaning of the terms and their immediate context

9.134 We shall examine the wider context of Article XXIV:5(a) and 8(a) as well as the object and purpose of GATT and the WTO Agreement, together with the practice of GATT CONTRACTING PARTIES and WTO Members with regard to these provisions, after our examination of the wording of Article XXIV:8(a). So far, based on the ordinary meaning of the terms and their immediate context, we find that … there is no legal basis in Article XXIV:5(a) for the introduction of quantitative restrictions otherwise incompatible with GATT/WTO; the wording of sub-paragraph 5(a) does not authorize Members forming a customs union to deviate from the prohibitions contained in Articles XI and XIII of GATT or Article 2.4 of the ATC. We find that the terms of sub-paragraph 5(a) provide for a prohibition against the formation of a customs union that

would be more restrictive, on the whole, than was the trade of its constituent members (even in situations where there are no WTO-incompatible measures).

4. Article XXIV:8

(a) Arguments of the parties

9.135 Turkey submits also that Article XXIV:8(a)(ii) requires it to apply to third countries the same regulations of commerce, including import restrictions as those applied by the European Communities to the same third countries, since the term *regulations of commerce* has traditionally been interpreted as incorporating quantitative restrictions. (…)

9.136 In India's view, however, Article XXIV:8(a) merely defines the requirements to be fulfilled by a regional trade agreement to qualify as a customs union within the meaning of Article XXIV. This provision could not reasonably be interpreted to imply that Members, in fulfilling that requirement, are entitled to ignore their WTO obligations, such as those prohibiting import restrictions from third Members. For India, Article XXIV:4 makes it clear that the purpose of a customs union is not to raise barriers to the trade of third countries.

(…)

9.139 Turkey submits further that, since, in order to qualify as a customs union, the Turkey-EC customs union must cover substantially all trade - as required by Article XXIV:8(a)(i) - it has obviously to cover trade in textiles and clothing products, which represents 40 per cent of Turkey's exports to the European Communities. For such trade in textiles and clothing to be covered, the constituent members of the Turkey-EC customs union must have common tariffs and a common foreign trade regime with other countries in accordance with Article XXIV:8(a)(ii). For Turkey, such common regulation of commerce, as determined by restrictive measures which the European Communities applies in conformity with WTO rules, must cover goods imported into the Turkey-EC customs union *via* Turkey. For Turkey, there is no alternative: in the context of the formation of its customs union with the European Communities, it was required to adopt the European Communities' external trade policy in textile and clothing products.

(…)

(b) Analysis of Article XXIV:8(a)

9.141 We note Turkey's arguments that if it wants to exercise its right to form a customs union with the European Communities, it has no alternative but to adopt exactly the same external trade policy as that of the European Communities and consequently, if need be, it is authorized by the provisions of Article XXIV:8(a)(ii) to violate the prohibition of Articles XI and XIII of GATT (and Article 2.4 of the ATC). We shall first examine the wording of Article XXIV:8(a)(i) and XXIV:8(a)(ii) and consider whether these provisions require Turkey to do what it claims to be required to do, namely to violate Articles XI and XIII of GATT and Article 2.4 of the ATC. In this context we shall discuss the relationship between Article XXIV and Article XI of GATT.

Finally, we will examine whether our interpretation of Article XXIV in the present case would prevent Turkey from exercising its right to form a customs union.

(i) The terms of paragraph 8(a)

9.142 Paragraph 8(a) of Article XXIV reads as follows:

> "8. For the purposes of this Agreement:
>
> (*a*) A customs union shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that
>
> (i) duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) 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, and,
>
> (ii) subject to the provisions of paragraph 9, 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;"

It is accepted that quantitative restrictions, such as the measures at issue in this case, are "restrictive regulations of commerce" for the purposes of Article XXIV:8(a).

(…)

9.144 With regard to the external dimension of any such customs union, the implied ultimate (and ideal) situation is that a complete single common foreign trade regime is adopted by the constituent members of the customs union.

9.145 We note that sub-paragraph 8(a)(i) of Article XXIV governs the internal trade between constituent members of a customs union. Sub-paragraph 8(a)(ii) governs the trade of the constituent members with third countries, and not the trade between the constituent members themselves.

9.146 The terms of sub-paragraph 8(a)(i) offer some flexibility to the constituent members of a customs union as also noted by Hong Kong, China. The standard is that "substantially all the trade between the constituent territories" must be fully liberalized among the constituent Members. This, in practice, can be accomplished only by providing preferential treatment to goods originating in the constituent territories. We are mindful that sub-paragraph 8(a)(i) is not directly relevant to this case, as India's claims do not concern any preferential treatment accorded by Turkey and the European Communities to each other as part of their customs union, but rather with the treatment of their trade with non-members of the customs union, i.e. Turkey's imposition of quantitative restrictions on Indian textiles and clothing. This is an issue mainly for consideration in light of Article XXIV:8(a)(ii), and the relationship between the two sub-paragraphs 8(a)(i) and 8(a)(ii).

9.147 In considering Turkey's Article XXIV:8(a) defense, we are mindful of the need to interpret Article XXIV in a manner to avoid conflicts with other WTO provisions (see paragraph

9.95 above). The issue we must consider now is whether Articles XI (and XIII) of GATT, on the one hand, and Article XXIV:8(a)(ii), on the other hand, may be interpreted so as to avoid a conflict requiring that one provision yields to the other. For the reasons explained below, we believe that, in this case, the flexibility inherent in sub-paragraph 8(a)(ii) allows for harmonious interpretation. That interpretation is in accordance with the context of the sub-paragraph 8(a)(ii) and the object and purpose of the WTO Agreement, and, at the same time, fully respects Turkey's right to enter into a customs union with other Members.

9.148 As Japan and Hong Kong, China stressed, we note at the outset that the terms of sub-paragraph 8(a)(ii) do not explicitly authorize Members of a customs union to violate GATT rules in their relations with non-constituent members. Nor do they implicitly require such a result. Indeed, the terms of sub-paragraph 8(a)(ii) allow for flexibility in the creation of a common commercial policy, as the standard used is that "substantially the same duties and other regulations of commerce are [to be] applied by each of the members of the [customs] union". We are aware that GATT CONTRACTING PARTIES and WTO Members have never reached agreement on the interpretation of the term "substantially" in the context of Article XXIV:8. The ordinary meaning of the term "substantially" in the context of sub-paragraph 8(a) appears to provide for both qualitative and quantitative components. The expression "substantially the same duties and other regulations of commerce are applied by each of the Members of the [customs] union" would appear to encompass both quantitative and qualitative elements, the-quantitative aspect more emphasized in relation to duties.[29]

9.149 We note also that sub-paragraphs 8(a)(i) and 8(a)(ii) address distinct but inter-linked policies. Therefore, the inclusion of a sector within the coverage of a customs union, i.e. the removal of all trade barriers in respect of products of that sector between the constituent members of the customs union, does not necessarily imply that those constituent members must apply identical barriers or barriers having similar effects to imports of the same products from third countries.

9.150 We note, however, in the terms of sub-paragraph 8(a)(i), the possibility for parties to a customs union to maintain certain restrictions of commerce on their trade with each other, including quantitative restrictions ("…where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX"). This implies that even for "substantially all trade originating in the constituent countries" to be covered (here, for instance, textile and clothing products), certain WTO compatible restrictions can be maintained. This implies that internal quantitative restrictions can be used in the event that only one of the constituent territories has in place a restriction on imports from third countries. If such pre-existing import restrictions were WTO compatible, the maintenance of an internal import restriction between the two constituent countries would ensure that the protection afforded by the original WTO compatible quota would not be circumvented. The maintenance of such an internal restriction can obviate the need for identical external trade policies. We note also that the plain meaning of the wording used in these two sub-paragraphs implies a difference in approach between efforts at internal trade liberalization among constituent members of a customs union where the maintenance of some quantitative restrictions (as restrictive regulations of commerce) is explicitly permitted (see paragraph 8(a)(i)), and their respective external policies with third countries where paragraph 8(a)(ii) contains no specific authorization relating to the maintenance of quantitative restrictions.

[29] We have also examined the French and Spanish versions of Article XXIV which confirm that flexibility is left to the constituent members.

9.151 Having said this, and recognizing such flexibility, many questions remain unanswered. We consider, however, that if the ideal situation were to be one where the policies of the constituent members are identical, there is nevertheless a wide range of possibilities left for Members to identify how they can form their customs union and to what extent and how, they should put in place their internal trade and their common foreign trade polices. Considering this wide range of possibilities, we are of the view that, as a general rule, a situation where constituent members have "comparable" trade regulations having similar effects with respect to the trade with third countries, would generally meet the qualitative dimension of the requirements of sub-paragraph 8(a)(ii). The possibility also exists of convergence across a very wide range of policy areas but with distinct exceptions in limited areas. The greater the degree of policy divergence, the lower the flexibility as to the areas in which this can occur; and vice-versa. In our view, our interpretation of sub-paragraph 8(a)(ii) allows Members to form a customs union, as in this case, where one constituent member is entitled to impose quantitative restrictions under a special transitional regime and the other constituent member is not.[30]

9.152 This interpretation seems to be confirmed by the effective practice of the Turkey-EC customs union. We note that in some sectors such as those relating to agriculture, steel etc, identical trade policies are not being applied by the constituent members. We note also that Decision 1/95 envisages that the European Communities may continue to apply its system of certificates of origin should Turkey fail to conclude agreements with third countries, similar to the agreements already in place between those countries and the European Communities.[31] Thus, there are administrative means, as stated by the United States, available to the European Communities and Turkey, and in particular rules of origin, as suggested by Hong Kong, China, in order to ensure that no trade diversion occurs, while respecting the parameters of sub-paragraph 8(a)(i) and at the same time of sub-paragraph 8(a)(ii), recalling that the two sets of policies under sub-paragraphs 8(a)(i) and 8(a)(ii) are distinct and the relationship between them is a flexible one.

9.153 Our interpretation of Article XXIV:8(a) is not such as to render Turkey's right to form a customs union a nullity. We note that Turkey's exports of textiles and clothing to the European Communities represent 40 per cent of its total exports to the European Communities. If Turkey wants to cover such trade and to ensure that it benefits from the advantages of the customs union, it can do so and comply with sub-paragraph 8(a)(i). In its discussion of the interpretation and application of sub-paragraph 8(a)(ii), Turkey's reference to the fact that textiles and clothing represents 40 per cent of its trade with the European Communities, is therefore of no relevance. With regard to its external trade policies, calculations based on import statistics provided by Turkey to the Panel show that, in 1995, 1996 and 1997, (a) textile and clothing imports from all non-EC countries (including WTO Members and non-Members) into Turkey represented between 8 and 9 per cent of Turkey's total imports from those countries; (b) imports from non-EC

[30] Our discussion of the flexibility offered by Article XXIV:8(a) is without prejudice to the further flexibility that may exist during the transition period of an interim agreement leading to a customs union.

[31] Article 12 of Decision 1/95 (WT/REG22/1) provides that: "2. In conformity with the requirements of Article XXIV of the GATT Turkey will apply as from the entry into force of this Decision, substantially the same commercial policy as the Community in the textile sector including the agreements or arrangements on trade in textile and clothing. The Community will make available to Turkey the cooperation necessary for this objective to be reached. 3.Until Turkey has concluded these arrangements, the present system of certificates of origin for the exports of textile and clothing from Turkey into the Community will remain in force and such products not originating from Turkey will remain subject to the application of the Communities Commercial Policy in relation to the third countries in question… In the absence of such modalities, the Community reserves the right to take, in respect of imports into its territory, any measure rendered necessary by the application of the said Arrangement."

countries of the products covered by all categories under restriction by Turkey represented 4.5 per cent of Turkey's total imports from those countries; and (c) imports from non-EC countries of the products covered by the 19 categories under restriction from India represented less than 3 per cent of Turkey's total imports from those countries.[32] It should be noted that the figures in (b) and (c) above, include both imports from WTO Members and non-Members. Thus, a variation in policy relevant to WTO Members on at most 4.5 per cent of Turkey's external trade, in any event of a temporary nature,[33] could not be considered in this case to jeopardise the requirement of Article XXIV:8(a)(ii) that substantially the same regulations of commerce are to be applied by Turkey and the European Communities to third countries. The fact that this proportion of trade is regulated in a different way by Turkey, cannot be seen to contradict the requirements of Article XXIV:8(a)(ii). …

9.154 Independently of the fact that constituent members could agree that some of their foreign trade policies may not be identical, we consider that the terms of sub-paragraph 8(a)(ii) do not address the issue of whether an otherwise WTO incompatible import restriction could be introduced among the identical or different trade policies on formation of a customs union. In our view, the terms of Article XXIV:8(a)(ii) do not provide any authorization for Members forming a customs union to violate the prescriptions of Articles XI and XIII of GATT or Article 2.4 of the ATC.

(ii) Immediate context

9.155 The conclusion that Article XXIV:8(a)(ii) should be read as not authorizing the violation of Articles XI and XIII of GATT or Article 2.4 of the ATC in the circumstances of this case is supported by the same contextual analysis that we developed relating to paragraph 5(a) (see paragraphs 9.124 to 9.133 above), and in particular, our analysis of paragraphs 4 and 6 of Article XXIV.

(iii) Conclusion

9.156 We conclude, based on the ordinary meaning of its terms and their immediate context, that Article XXIV:8(a) does not address explicitly the issue of the GATT/WTO compatibility of the measures adopted by constituent members of a customs union in their effort to align substantially all their duties and regulations of commerce *vis-à-vis* third countries. In any case, we consider that, in this case, Article XXIV:8(a)(ii) does not authorize Turkey, in forming a customs union with the European Communities, to introduce quantitative restrictions on textile and clothing products that would be otherwise incompatible with GATT/WTO, nor does it require that Turkey introduce restrictions on imports of textiles and clothing which would be inconsistent with other provisions of the WTO Agreement.

[32] This results from the fact that, Turkey as an important clothing manufacturer, imports mainly textile products and these are only partially represented in the restricted categories (only 6, out of the 19 categories, refer to textile yarn or fabrics). (See para. 2.46 above and Annex to this report, Appendix 1.)
[33] The European Communities' MFA-derived quantitative restrictions must be eliminated by 1 January 2005.

(c) The wider context of Article XXIV:5 and 8 and the object and purpose of the agreements

9.157 We consider that the wider context of sub-paragraphs 5(a) and 8(a) and Article XXIV generally, as well as the object and purpose of the WTO Agreement, and GATT 1994, including the GATT 1994 Understanding on Article XXIV, are also relevant to the interpretation of Article XXIV and confirm our interpretation of the provisions of sub-paragraphs 5(a) and 8(a) of Article XXIV.

9.158 We note that the Preamble to the GATT 1947 (now GATT 1994) provides that:

> "Recognizing that their relations in the field of trade …should be conducted with a view to … and *expanding the production and exchange of goods*," (emphasis added)

9.159 Such language suggests that a global objective of GATT 1947 was, and of GATT 1994 is, to increase trade by reducing (making less restrictive) tariffs and lowering non-tariff barriers. It is a dynamic objective. The use of regional trade agreements to achieve that objective is legitimized by the first sentence of Article XXIV:4:

> "The contracting parties recognize the desirability of *increasing freedom of trade* by the development, through voluntary agreements, of closer integration between the economies of the countries parties to such agreements." (emphasis added)

9.160 Already then it was clear to CONTRACTING PARTIES that the overall objective of GATT and for that matter, regional trade agreements, should not be to raise barriers to trade. This is also noted in the Philippines' submission.[34] This is reflected in the wording of the second sentence of paragraph 4 of Article XXIV:

> "They also recognize that the purpose of a customs union or of a free-trade area should be to facilitate trade between the constituent territories *and not to raise barriers to the trade of other contracting parties* with such territories." (emphasis added)

and in the Preamble to GATT 1947:

> "Being desirous of contributing to these objectives by entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the *elimination of discriminatory treatment* in international commerce …"(emphasis added)

(…)

9.163 From the above cited provisions,[35] we draw two general conclusions for the present case. Firstly, the objectives of regional trade agreements and those of the GATT and the WTO have always been complementary, and therefore should be interpreted consistently with one another, with a view to increasing trade and not to raising barriers to trade, thereby arguing against an

[34] See para. 7.41 above.
[35] We note that the wording of Article V of GATS refers to the same concepts.

interpretation that would allow, on the occasion of the formation of a customs union, for the introduction of quantitative restrictions. Secondly, we read in these parallel objectives a recognition that the provisions of Article XXIV (together with those of the GATT 1994 Understanding on Article XXIV) do not constitute a shield from other GATT/WTO prohibitions, or a justification for the introduction of measures which are considered generally to be *ipso facto* incompatible with GATT/WTO. In our view the provisions of Article XXIV on regional trade agreements cannot be considered to exempt constituent members of a customs union from the primacy of the WTO rules. In this context we also note the Singapore Ministerial Declaration where Members stated: "We reaffirm the primacy of the multilateral trading system…".

(…)

(e) Temporary nature of the Turkish quantitative restrictions

9.170 Turkey also argues that because its import restrictions at issue are essentially temporary in nature, since under the ATC all quantitative restrictions should be phased out by 1 January 2005, it should be authorized to maintain them, even if they appear to be GATT/WTO incompatible.

9.171 We consider that the duration of quantitative restrictions does not alter the nature of such measures. The GATT/WTO prohibition against quantitative restrictions does not provide for any allowance for "short-time quantitative restrictions" or any similar time consideration. In the present case, a measure which is not in conformity with the WTO Agreement cannot become WTO compatible just because of its limited duration. We must therefore reject this latter argument by Turkey. Indeed, the transitional nature of the ATC and the possibility under Article XXIV to phase in a customs union argues against an exception in favour of temporary measures.

(…)

5. Conclusion

(…)

9.187 The wording of Article XXIV:4 refers to the objectives of Article XXIV, in the same terms as used in the Preamble to GATT 1947 (now GATT 1994); the same objectives are repeated in the GATT 1994 Understanding on Article XXIV and in the Preamble of the WTO Agreement. Paragraph 6 also refers to the provisions of Article XXVIII and provides specific procedures for the re-negotiation of tariff bindings, confirming thereby the applicability of other GATT provisions. To us, this confirms the nature of the WTO Agreement, as a single undertaking and that the provisions of Article XXIV are to be applied together with and not separately from the rest of the WTO Agreement. The Appellate Body has indeed repeated on several occasions that the WTO Agreement contains several obligations which must be complied with simultaneously, unless there is a conflict between the said provisions. Moreover we have noted that the wording of Article XXIV:4, with its reference to "should not raise barriers to trade" which appeared in GATT 1947, has continued to be determinative of the parameters of Article XXIV as evidenced by the wording of the GATT 1994 Understanding on Article XXIV and the Singapore Ministerial Declaration.

9.188 With regard to the specific relationship between, in the case before us, Article XXIV and Articles XI and XIII (and Article 2.4 of the ATC), we consider that the wording of Article XXIV

does not authorize a departure from the obligations contained in Articles XI and XIII of GATT and Article 2.4 of the ATC. We base our findings on the nature of the conditional right established in Article XXIV as opposed to the clear and unambiguous obligation in Article XI prohibiting the use of quantitative restrictions, notwithstanding the specific contrary practice which has in the past existed in the sector of textiles and clothing but which the ATC represents a collective commitment to terminate. As further discussed above, we consider that it is possible, and even necessary in order to avoid a conclusion that would lead to politically and economically absurd results, to interpret the provisions of Article XXIV in such a way as to avoid conflicts with the prescriptions of Articles XI and XIII of GATT, and Article 2.4 of the ATC.

9.189 As we have noted, paragraphs 5 and 8 of Article XXIV provide parameters for the establishment and assessment of a customs union, but in doing so allow flexibility in the choice of measures to be put in place on the formation of a customs union. In this context we recall the use of the terms "substantially all the trade" and "substantially the same duties and other regulations of commerce". While the meaning of these terms is not precisely clear in relation to what and how much constitute "substantially", they do confirm clearly that in both cases the standard is not all. These provisions do not, however, address any specific measures that may or may not be adopted on the formation of a customs union and importantly they do not authorize violations of Articles XI and XIII, and Article 2.4 of the ATC. Moreover, we note that paragraph 6 of Article XXIV provides for a specific procedure for the renegotiation of tariffs which are increased above their bindings upon formation of a customs union; no such provision exists for quantitative restrictions. To the Panel, if the introduction of WTO inconsistent quantitative restrictions were intended to be negotiable on the formation of a customs union, it would seem odd to us that an explicit procedure would exist for changes in GATT's preferred form of trade barrier (i.e. tariffs), while no procedure would be provided for negotiation of compensation connected with imposition of otherwise GATT inconsistent measures. We draw the conclusion that even on the occasion of the formation of a customs union, Members cannot impose otherwise incompatible quantitative restrictions.

9.190 We have further considered, in the context of these conclusions on Turkey's defense based on Article XXIV, the scope of flexibility allowed for in Article XXIV. However, this flexibility does not allow for the introduction of measures otherwise incompatible with the WTO Agreement. We consider that means for securing the objectives of Turkey in relation to the specific circumstances of forming its customs union with the European Communities, exist in the form of alternatives (e.g. increased tariffs, rules of origin, early phase-out, tariffication) to the imposition of quantitative restrictions imposed against imports from third countries, thereby interpreting Article XXIV in such a way as to avoid such conflict with other WTO provisions. In particular, our interpretation of paragraph 8(a)(ii) allows parties to form a customs union, as in this case, where one constituent member is entitled to impose quantitative restrictions under a special transitional regime and the other constituent is not.

9.191 Finally, we recall that the prohibitions against quantitative restrictions in the sector of textiles and clothing constitute a fundamental feature of the WTO Agreement which argues strongly against the introduction of any new such restrictions in that sector. Moreover, considering the … inherently transitional nature of quantitative import restrictions in the sector of textiles and clothing, we find that Turkey was in a position to avoid the violations of Articles XI and XIII of GATT, and Article 2.4 of the ATC.

9.192 Consequently, we reject Turkey's defense that Article XXIV allows it to introduce, upon the formation of its customs union with the European Communities, quantitative restrictions on 19

categories of textile and clothing products, in violation of Articles XI and XIII of GATT and Article 2.4 of the ATC.

(…)

X. CONCLUSIONS

10.1 We conclude that the measures adopted by Turkey on 19 categories of textile and clothing products are inconsistent with the provisions of Articles XI and XIII of GATT and consequently with those of Article 2.4 of the ATC. We reject Turkey's defense that the introduction of any such otherwise GATT/WTO incompatible import restrictions is permitted by Article XXIV of GATT.

(…)

10.3 The Panel *recommends* that the Dispute Settlement Body request Turkey to bring its measures into conformity with its obligations under the WTO Agreement.

2-3. Report of the Appellate Body, WT/DS34/AB/R, 22 October 1999

Beeby, Presiding Member, Bacchus, Member, El-Naggar, Member

Editorial Note: The footnote numbering in this report does not necessarily correspond to the footnote numbering in the original.

I. INTRODUCTION

1. Turkey appeals from certain issues of law and legal interpretations in the Panel Report, *Turkey – Restrictions on Imports of Textile and Clothing Products* (the "Panel Report").[1] The Panel was established to consider a complaint by India regarding quantitative restrictions introduced by Turkey on imports of Indian textile and clothing products.

2. On 6 March 1995, the Turkey-EC Association Council adopted Decision 1/95,[2] which sets out the rules for implementing the final phase of the customs union between Turkey and the European Communities. Article 12(2) of this Decision states:

> In conformity with the requirements of Article XXIV of the GATT Turkey will apply as from the entry into force of this Decision, substantially the same commercial policy as the Community in the textile sector including the agreements or arrangements on trade in textile and clothing.

In order to apply what it considered to be "substantially the same commercial policy" as the European Communities on trade in textiles and clothing, Turkey introduced, as of 1 January 1996, quantitative restrictions on imports from India on 19 categories of textile and clothing products.[3]

3. The Panel considered claims by India that the quantitative restrictions introduced by Turkey were inconsistent with Articles XI and XIII of the GATT 1994, and Article 2.4 of the Agreement on Textiles and Clothing (the "*ATC*"). In the Panel Report, circulated on 31 May 1999, the Panel reached the conclusion that the quantitative restrictions were inconsistent with the provisions of Articles XI and XIII of the GATT 1994 and consequently with those of Article 2.4 of the *ATC*, and rejected Turkey's defence that the introduction of any such otherwise GATT/WTO incompatible import restrictions is permitted by Article XXIV of the GATT 1994.[4]

(…)

[1]WT/DS34/R, 31 May 1999.
[2]Reproduced in WT/REG22/1.
[3]For a further discussion of the underlying facts and a more detailed description of the products involved in this case, see the Panel Report, paras. 2.2-2.46 and 4.1-4.3, and the Annex to the Report.
[4]Panel Report, para. 10.1.

IV. ISSUE RAISED IN THIS APPEAL

41. The issue raised by Turkey in this appeal is whether these quantitative restrictions are nevertheless justified by Article XXIV of the GATT 1994.

V. ARTICLE XXIV OF THE GATT 1994

42. In examining Turkey's defence that Article XXIV of the GATT 1994 allowed Turkey to adopt the quantitative restrictions at issue in this appeal, the Panel looked, first, at Article XXIV:5(a) and, then, at Article XXIV:8(a) of the GATT 1994. The Panel examined the ordinary meaning of the terms of these provisions, in their context and in the light of the object and purpose of the *WTO Agreement*. The Panel reached the following conclusions:

> With regard to the specific relationship between, in the case before us, Article XXIV and Articles XI and XIII (and Article 2.4 of the ATC), we consider that the wording of Article XXIV does not authorize a departure from the obligations contained in Articles XI and XIII of GATT and Article 2.4 of the ATC.
>
> (…)
>
> [Paragraphs 5 and 8 of Article XXIV] do not … address any specific measures that may or may not be adopted on the formation of a customs union and importantly they do not authorize violations of Articles XI and XIII, and Article 2.4 of the ATC. … We draw the conclusion that even on the occasion of the formation of a customs union, Members cannot impose otherwise incompatible quantitative restrictions.[5]

Consequently, the Panel rejected Turkey's defence that Article XXIV justifies the introduction of the quantitative restrictions at issue. Turkey appeals the Panel's interpretation of Article XXIV.

43. We note that, in its findings, the Panel referred to the chapeau of paragraph 5 of Article XXIV only in a passing and perfunctory way. The chapeau of paragraph 5 is not central to the Panel's analysis, which focuses instead primarily on paragraph 5(a) and paragraph 8(a). However, we believe that the chapeau of paragraph 5 of Article XXIV is the key provision for resolving the issue before us in this appeal. In relevant part, it reads:

> Accordingly, the provisions of this Agreement *shall not prevent*, as between the territories of contracting parties, *the formation of a customs union* …; *Provided* that: … (emphasis added)

44. To determine the meaning and significance of the chapeau of paragraph 5, we must look at the text of the chapeau, and its context, which, for our purposes here, we consider to be paragraph 4 of Article XXIV.

[5] *Ibid*., paras. 9.188 and 9.189.

45. First, in examining the text of the chapeau to establish its ordinary meaning, we note that the chapeau states that the provisions of the GATT 1994 "*shall not prevent*" the formation of a customs union. We read this to mean that the provisions of the GATT 1994 *shall not make impossible* the formation of a customs union.[6] Thus, the chapeau makes it clear that Article XXIV may, under certain conditions, justify the adoption of a measure which is inconsistent with certain other GATT provisions, and may be invoked as a possible "defence" to a finding of inconsistency.[7]

46. Second, in examining the text of the chapeau, we observe also that it states that the provisions of the GATT 1994 shall not prevent "*the formation of a customs union*". This wording indicates that Article XXIV can justify the adoption of a measure which is inconsistent with certain other GATT provisions only if the measure is introduced upon the formation of a customs union, and only to the extent that the formation of the customs union would be prevented if the introduction of the measure were not allowed.

47. It follows necessarily that the text of the chapeau of paragraph 5 of Article XXIV cannot be interpreted without reference to the definition of a "customs union". This definition is found in paragraph 8(a) of Article XXIV, which states, in relevant part:

> A customs union shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that:
>
> (i) duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) 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, and,
>
> (ii) … *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. (emphasis added)

48. Sub-paragraph 8(a)(i) of Article XXIV establishes the standard for the *internal trade* between constituent members in order to satisfy the definition of a "customs union". It requires the constituent members of a customs union to eliminate "duties and other restrictive regulations

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[6]"Prevent" is defined as "make impracticable or impossible by anticipatory action; stop from happening." *The New Shorter Oxford English Dictionary* (Clarendon Press, 1993), Vol. II, at 2348.

[7]We note that legal scholars have long considered Article XXIV to be an "exception" or a possible "defence" to claims of violation of GATT provisions. (…) The chapeau of paragraph 5 refers only to the provisions of the GATT 1994. It does not refer to the provisions of the *ATC*. However, Article 2.4 of the *ATC* provides that "[n]o new restrictions … shall be introduced *except under* the provisions of this Agreement or *relevant GATT 1994 provisions*." (emphasis added) In this way, Article XXIV of the GATT 1994 is incorporated in the *ATC* and may be invoked as a defence to a claim of inconsistency with Article 2.4 of the *ATC*, provided that the conditions set forth in Article XXIV for the availability of this defence are met.

of commerce" with respect to "substantially all the trade" between them. Neither the GATT CONTRACTING PARTIES nor the WTO Members have ever reached an agreement on the interpretation of the term "substantially" in this provision.[8] It is clear, though, that "substantially all the trade" is not the same as *all* the trade, and also that "substantially all the trade" is something considerably more than merely *some* of the trade. We note also that the terms of sub-paragraph 8(a)(i) provide that members of a customs union may maintain, where necessary, in their internal trade, certain restrictive regulations of commerce that are otherwise permitted under Articles XI through XV and under Article XX of the GATT 1994. Thus, we agree with the Panel that the terms of sub-paragraph 8(a)(i) offer "some flexibility" to the constituent members of a customs union when liberalizing their internal trade in accordance with this sub-paragraph.[9] Yet we caution that the degree of "flexibility" that sub-paragraph 8(a)(i) allows is limited by the requirement that "duties and other restrictive regulations of commerce" be "eliminated with respect to substantially all" internal trade.

49. Sub-paragraph 8(a)(ii) establishes the standard for the trade of constituent members *with third countries* in order to satisfy the definition of a "customs union". It requires the constituent members of a customs union to apply "substantially the same" duties and other regulations of commerce to external trade with third countries. The constituent members of a customs union are thus required to apply a common external trade regime, relating to both duties and other regulations of commerce. However, sub-paragraph 8(a)(ii) does *not* require each constituent member of a customs union to apply *the same* duties and other regulations of commerce as other constituent members with respect to trade with third countries; instead, it requires that *substantially the same* duties and other regulations of commerce shall be applied. We agree with the Panel that:

> [t]he ordinary meaning of the term "substantially" in the context of sub-paragraph 8(a) appears to provide for both qualitative and quantitative components. The expression "substantially the same duties and other regulations of commerce are applied by each of the Members of the [customs] union" would appear to encompass both quantitative and qualitative elements, the quantitative aspect more emphasized in relation to duties.[10]

50. We also believe that the Panel was correct in its statement that the terms of sub-paragraph 8(a)(ii), and, in particular, the phrase "substantially the same" offer a certain degree of "flexibility" to the constituent members of a customs union in "the creation of a common commercial policy."[11] Here too we would caution that this "flexibility" is limited. It must not be forgotten that the word "substantially" qualifies the words "the same". Therefore, in our view, something closely approximating "sameness" is required by Article XXIV:8(a)(ii). We do not agree with the Panel that:

> … as a general rule, a situation where constituent members have "comparable" trade regulations having similar effects with respect to the trade with third countries, would generally meet the

[8]Panel Report, para. 9.148.
[9]*Ibid*., para. 9.146.
[10]Panel Report, para. 9.148.
[11]*Ibid*.

> qualitative dimension of the requirements of sub-paragraph 8(a)(ii).[12]

Sub-paragraph 8(a)(ii) requires the constituent members of a customs union to adopt "substantially the same" trade regulations. In our view, "comparable trade regulations having similar effects" do not meet this standard. A higher degree of "sameness" is required by the terms of sub-paragraph 8(a)(ii).

51. Third, in examining the text of the chapeau of Article XXIV:5, we note that the chapeau states that the provisions of the GATT 1994 shall not prevent the formation of a customs union "*Provided that*". The phrase "*provided that*" is an essential element of the text of the chapeau. In this respect, for purposes of a "customs union", the relevant proviso is set out immediately following the chapeau, in Article XXIV:5(a). It reads in relevant part:

> with respect to a customs union …, the duties and other regulations of commerce imposed at the institution of any such union … in respect of trade with contracting parties not parties to such union … shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such union …;

52. Given this proviso, Article XXIV can, in our view, only be invoked as a defence to a finding that a measure is inconsistent with certain GATT provisions to the extent that the measure is introduced upon the formation of a customs union which meets the requirement in sub-paragraph 5(a) of Article XXIV relating to the "duties and other regulations of commerce" applied by the constituent members of the customs union to trade with third countries.

53. With respect to "duties", Article XXIV:5(a) requires that the duties applied by the constituent members of the customs union *after* the formation of the customs union "shall *not* on the whole be *higher* … than the *general incidence*" of the duties that were applied by each of the constituent members before the formation of the customs union. Paragraph 2 of the *Understanding on Article XXIV* requires that the evaluation under Article XXIV:5(a) of the *general incidence of the duties* applied before and after the formation of a customs union "shall … be based upon an overall assessment of weighted average tariff rates and of customs duties collected."[13] Before the agreement on this Understanding, there were different views among the GATT Contracting Parties as to whether one should consider, when applying the test of Article XXIV:5(a), the *bound* rates of duty or the *applied* rates of duty. This issue has been resolved by paragraph 2 of the *Understanding on Article XXIV*, which clearly states that the *applied* rate of duty must be used.

54. With respect to "other regulations of commerce", Article XXIV:5(a) requires that those applied by the constituent members *after* the formation of the customs union "shall *not* on the whole be … *more restrictive* than the *general incidence*" of the regulations of commerce that were applied by each of the constituent members *before* the formation of the customs union.

[12] *Ibid*., para. 9.151.

[13] Paragraph 2 of the *Understanding on Article XXIV* further states that "this assessment shall be based on import statistics for a previous representative period to be supplied by the customs union, on a tariff-line basis and in values and quantities, broken down by WTO country of origin."

Paragraph 2 of the *Understanding on Article XXIV* explicitly recognizes that the quantification and aggregation of regulations of commerce other than duties may be difficult, and, therefore, states that "for the purpose of the overall assessment of the incidence of other regulations of commerce for which quantification and aggregation are difficult, the examination of individual measures, regulations, products covered and trade flows affected may be required."[14]

55. We agree with the Panel that the terms of Article XXIV:5(a), as elaborated and clarified by paragraph 2 of the *Understanding on Article XXIV*, provide:

> … that the effects of the resulting trade measures and policies of the new regional agreement shall not be more trade restrictive, overall, than were the constituent countries' previous trade policies.[15]

and we also agree that this is:

> an "economic" test for assessing whether a specific customs union is compatible with Article XXIV.[16]

56. The text of the chapeau of paragraph 5 must also be interpreted in its context. In our view, paragraph 4 of Article XXIV constitutes an important element of the context of the chapeau of paragraph 5. The chapeau of paragraph 5 of Article XXIV begins with the word "accordingly", which can only be read to refer to paragraph 4 of Article XXIV, which immediately precedes the chapeau. Paragraph 4 states:

> The contracting parties recognize the desirability of increasing freedom of trade by the development, through voluntary agreements, of closer integration between the economies of the countries parties to such agreements. They also recognize that the purpose of a customs union or of a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories.

57. According to paragraph 4, the purpose of a customs union is "to facilitate trade" between the constituent members and "not to raise barriers to the trade" with third countries. This objective demands that a balance be struck by the constituent members of a customs union. A customs union should facilitate trade within the customs union, but it should *not* do so in a way that raises barriers to trade with third countries. We note that the *Understanding on Article XXIV* explicitly reaffirms this purpose of a customs union, and states that in the formation or enlargement of a customs union, the constituent members should "to the greatest possible extent avoid creating adverse affects on the trade of other Members".[17] Paragraph 4 contains purposive, and not operative, language. It does not set forth a separate obligation itself but, rather, sets forth the overriding and pervasive purpose for Article XXIV which is manifested in operative language

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[14]In paragraph 43 of its appellant's submission, Turkey argues that this provision must be interpreted as allowing the constituent members of a customs union to introduce GATT/WTO inconsistent quantitative restrictions upon the formation of the customs union. We see no basis for such an interpretation.
[15]Panel Report, para. 9.121.
[16]*Ibid*., para. 9.120.
[17]*Understanding on Article XXIV*, Preamble.

in the specific obligations that are found elsewhere in Article XXIV. Thus, the purpose set forth in paragraph 4 informs the other relevant paragraphs of Article XXIV, including the chapeau of paragraph 5. For this reason, the chapeau of paragraph 5, and the conditions set forth therein for establishing the availability of a defence under Article XXIV, must be interpreted in the light of the purpose of customs unions set forth in paragraph 4. The chapeau cannot be interpreted correctly without constant reference to this purpose.

58. Accordingly, on the basis of this analysis of the text and the context of the chapeau of paragraph 5 of Article XXIV, we are of the view that Article XXIV may justify a measure which is inconsistent with certain other GATT provisions. However, in a case involving the formation of a customs union, this "defence" is available only when two conditions are fulfilled. First, the party claiming the benefit of this defence must demonstrate that the measure at issue is introduced upon the formation of a customs union that fully meets the requirements of sub-paragraphs 8(a) and 5(a) of Article XXIV. And, second, that party must demonstrate that the formation of that customs union would be prevented if it were not allowed to introduce the measure at issue. Again, *both* these conditions must be met to have the benefit of the defence under Article XXIV.

59. We would expect a panel, when examining such a measure, to require a party to establish that both of these conditions have been fulfilled. It may not always be possible to determine whether the second of the two conditions has been fulfilled without initially determining whether the first condition has been fulfilled. In other words, it may not always be possible to determine whether not applying a measure would prevent the formation of a customs union without first determining whether there *is* a customs union. In this case, the Panel simply assumed, for the sake of argument, that the first of these two conditions was met and focused its attention on the second condition.

(…)

61. With respect to the second condition that must be met to have the benefit of the defence under Article XXIV, Turkey asserts that had it not introduced the quantitative restrictions on textile and clothing products from India that are at issue, the European Communities would have "exclud[ed] these products from free trade within the Turkey/EC customs union". According to Turkey, the European Communities would have done so in order to prevent trade diversion. Turkey's exports of these products accounted for 40 per cent of Turkey's total exports to the European Communities.[18] Turkey expresses strong doubts about whether the requirement of Article XXIV:8(a)(i) that duties and other restrictive regulations of commerce be eliminated with respect to "substantially all trade" between Turkey and the European Communities could be met if 40 per cent of Turkey's total exports to the European Communities were excluded. In this way, Turkey argues that, unless it is allowed to introduce quantitative restrictions on textile and clothing products from India, it would be prevented from meeting the requirements of Article XXIV:8(a)(i) and, thus, would be prevented from forming a customs union with the European Communities.

62. We agree with the Panel that had Turkey not adopted the same quantitative restrictions that are applied by the European Communities, this would not have prevented Turkey and the European Communities from meeting the requirements of sub-paragraph 8(a)(i) of Article XXIV, and consequently from forming a customs union. We recall our conclusion that the terms of sub-paragraph 8(a)(i) offer some – though limited – flexibility to the constituent members of a

[18]Panel Report, para. 9.153.

customs union when liberalizing their internal trade.[19] As the Panel observed, there are other alternatives available to Turkey and the European Communities to prevent any possible diversion of trade, while at the same time meeting the requirements of sub-paragraph 8(a)(i).[20] For example, Turkey could adopt rules of origin for textile and clothing products that would allow the European Communities to distinguish between those textile and clothing products originating in Turkey, which would enjoy free access to the European Communities under the terms of the customs union, *and* those textile and clothing products originating in third countries, including India. In fact, we note that Turkey and the European Communities themselves appear to have recognized that rules of origin could be applied to deal with any possible trade diversion. Article 12(3) of Decision 1/95 of the EC-Turkey Association Council, which sets out the rules for implementing the final phase of the customs union between Turkey and the European Communities, specifically provides for the possibility of applying a system of certificates of origin.[21] A system of certificates of origin would have been a reasonable alternative until the quantitative restrictions applied by the European Communities are required to be terminated under the provisions of the *ATC*. Yet no use was made of this possibility to avoid trade diversion. Turkey preferred instead to introduce the quantitative restrictions at issue.

63. For this reason, we conclude that Turkey was not, in fact, required to apply the quantitative restrictions at issue in this appeal in order to form a customs union with the European Communities. Therefore, Turkey has not fulfilled the second of the two necessary conditions that must be fulfilled to be entitled to the benefit of the defence under Article XXIV. Turkey has not demonstrated that the formation of a customs union between Turkey and the European Communities would be prevented if it were not allowed to adopt these quantitative restrictions. Thus, the defence afforded by Article XXIV under certain conditions is not available to Turkey in this case, and Article XXIV does not justify the adoption by Turkey of these quantitative restrictions.

VI. FINDINGS AND CONCLUSIONS

64. For the reasons set out in this report, the Appellate Body concludes that the Panel erred in its legal reasoning by focusing on sub-paragraphs 8(a) and 5(a) and by failing to recognize the crucial role of the chapeau of paragraph 5 in the interpretation of Article XXIV of the GATT 1994, but upholds the Panel's conclusion that Article XXIV does not allow Turkey to adopt, upon the formation of a customs union with the European Communities, quantitative restrictions on imports of 19 categories of textile and clothing products which were found to be inconsistent with Articles XI and XIII of the GATT 1994 and Article 2.4 of the *ATC*.

65. We wish to point out that we make no finding on the issue of whether quantitative restrictions found to be inconsistent with Article XI and Article XIII of the GATT 1994 will *ever*

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[19] *Supra*, para. 48

[20] Panel Report, para. 9.152.

[21] Article 12(3) reads as follows:

> Until Turkey has concluded these arrangements, the present *system of certificates of origin for the exports of textile and clothing* from Turkey into the Community will remain in force and such products not originating from Turkey will remain subject to the application of the Communities Commercial Policy in relation to the third countries in question. (emphasis added).

be justified by Article XXIV. We find only that the quantitative restrictions at issue in the appeal in this case were not so justified. Likewise, we make no finding either on many other issues that may arise under Article XXIV. The resolution of those other issues must await another day. We do not believe it necessary to find more than we have found here to fulfill our responsibilities under the DSU in deciding this case.

66. The Appellate Body recommends that the DSB request that Turkey bring its measures which the Panel found to be inconsistent with Articles XI and XIII of the GATT 1994 and Article 2.4 of the *ATC* into conformity with its obligations under these agreements.