WTO Restraints on Regionalism

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The regionalism rules in the General Agreement on Tariffs and Trade ("GATT") were not expected to have much significance. The General Agreement was negotiated in 1947 at a time when open trade was seen as a way of linking economies together and making nations less likely to go to war with each other. Only twenty-three countries were party to the original negotiations and it was not anticipated that there would be many smaller regional agreements. The regionalism rules operate as an exception to other obligations in GATT, particularly the obligation of most-favoured-nation ("MFN") treatment which requires that trade advantages be made available immediately and unconditionally to all GATT members.

This short paper first outlines the restraints on regionalism in GATT, which were carried over to its successor organization, the World Trade Organization ("WTO"). The paper then addresses two issues of particular relevance for the proposed Free Trade Area of the Americas ("FTAA"): special and differential treatment for developing countries and the democracy clause. The conclusion offers a few comments on the suitability of the WTO framework for the challenges confronting the Americas at the beginning of the 21st century.

1. **GATT to WTO**

GATT provisions cover trade in goods and are directed to reducing tariff barriers, the main concern in the post-World War II economy. As tariffs were gradually lowered (particularly for industrial goods), attention turned to non-tariff barriers to trade. Agreements were negotiated on various non-tariff barriers, including anti-dumping duties, countervailing duties, customs valuation, standards, safeguards, rules of origin, pre-shipment inspection and import licensing procedures. The package for trade in goods adopted with the establishment of the WTO in 1995 includes the updated versions of these agreements on non-tariff barriers as well as the original General Agreement on Tariffs and Trade, slightly edited, as "GATT 1994". At the same time, the WTO expanded to cover services and technology, areas that had increased in economic

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importance. WTO coverage now includes the General Agreement on Trade in Services ("GATS") as well as the Agreement on Trade-Related Aspects of Intellectual Property Rights ("TRIPS").

Regional agreements were not common in the early years of GATT operation. They increased in frequency particularly during the 1990's, so that in 1995 when the WTO was formed, nearly all the members of the new organization were also concurrently members of at least one regional trade agreement.[2] The main provision governing such agreements is GATT Article XXIV, which applies to both free trade agreements and customs unions.[3] Concerning free trade agreements such as the proposed FTAA, Article XXIV establishes two main requirements. The first requirement relates to internal trade. The proposed free trade agreement must eliminate "duties and other restrictive regulations of commerce ... on substantially all the trade between the constituent territories in products originating in such territories" (Art.XXIV:8(b)). This obligation is subject to exceptions, where necessary, for restrictive regulations of commerce permitted by Articles XI to XV (quantitative restrictions and currency exchange arrangements) and Article XX (general exceptions to GATT). Restrictive regulations of commerce in the member countries that meet the internal trade exception do not have to be eliminated. The second main requirement for a free trade agreement relates to external trade with other WTO countries that are not members of the free trade agreement. In external trade, 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 prior to the formation of the free-trade area" (Art.XXIV:5(b)).

A free trade agreement, thus, is supposed to remove tariffs and some other trade barriers internally while not increasing the burden of duties and other regulations of commerce in external trade. The requirements concerning tariff levels are fairly straightforward. Tariffs must be eliminated internally on products of the member-countries and they cannot be increased in external trade. More complex issues are posed by the requirements to eliminate some restrictive regulations of commerce in internal trade and to avoid making non-tariff regulations of commerce more restrictive in external trade. These issues must be interpreted against the general background of GATT 1994 obligations providing for national treatment and MFN treatment for

[2]WTO, Secretariat, *Regionalism and the World Trading System* (Geneva: WTO, 1995) at 27.

[3]A free trade area differs from a customs union in that member-countries of a free trade area continue to apply their own tariffs and commercial policies in external trade with non-members of the area. In a customs union, member-countries have a common tariff and commercial policy toward the outside. Most of the analysis below focuses on free trade areas.

all WTO members.

The requirement concerning internal trade has been raised in dispute settlement, but the matter is unresolved. The issue has had to do with safeguards, measures that a WTO member may impose to deal with unexpected increases in imports that cause serious injury to domestic producers. Safeguards are authorized under Article XIX of GATT, not one of the articles listed as exempted from the obligation to eliminate internal trade barriers. The argument is therefore made that safeguard measures are not permitted in internal trade. When the issue came up in dispute settlement involving safeguard measures applied against external trade but not to products from free trade partners, a counterargument was presented. According to the counterargument, outside countries' MFN rights are denied if they bear the burden of a safeguard action while exports continue from the free trade partner. In effect, the counterargument treats this situation as a non-tariff regulation of commerce that has become more restrictive as a result of the free trade agreement.[4] To date, the Appellate Body has not ruled definitively on this issue.[5]

The Appellate Body examined external trade requirements in the *Turkey-Textiles* dispute, which involved the formation of a customs union between Turkey and the European Communities. As part of the common external commercial policy for the new customs union, Turkey adopted the EC's quantitative restrictions on textiles and clothing. India complained that its MFN rights as an exporter were denied and the Appellate Body agreed. Countries establishing a common commercial policy in a customs union have some leeway so long as the new arrangement is not "on the whole" more restrictive to external trade (Art.XXIV:5(a)), but still the guiding principle for interpretation of Article XXIV is that other GATT obligations are not to *prevent* the formation of free trade areas or customs unions (Art.XXIV:5). Since the EC's quantitative restrictions could be maintained through a system of certificates of origin to be applied at the Turkey-EC border, formation of the customs union would not have been *prevented* if Turkey had

[4]One reply to the counterargument involves paragraphs 2 and 3 of Article XIX, which provide for negotiations and remedial action when safeguards are imposed. See further Agreement on Safeguards, Articles 2 and 4, plus footnote 1 to the Agreement..

[5]In the decisions, such safeguard measures have been found incompatible with GATT obligations, in part for failing to demonstrate the required link between imports and injury. See: Appellate Body Report, *Argentina - Safeguard Measures on Footwear,* WT/DS121/AB/R, adopted 12 January 2000, paras. 99-114 (A member of a customs union cannot investigate imports from all sources and then impose a safeguard only against non-customs union imports); Appellate Body Report, *United States - Safeguard Measures on Wheat Gluten*, WT/DS166/AB/R, adopted 19 January 2001, paras. 93-100 (A member of a free trade area cannot investigate imports from all sources and then impose a safeguard only against non-FTA imports, even when it has investigated the excluded FTA imports separately and found that they do not contribute importantly to injury); Appellate Body Report, *United States - Safeguard Measures on Line Pipe*, WT/DS202/AB/R, adopted 8 March 2002, paras. 178-199 (A member of a free trade area cannot investigate imports from all sources and then impose a safeguard only against non-FTA imports without establishing explicitly that imports from those non-FTA sources by themselves caused serious injury); Appellate Body Report, *United States - Safeguard Measures on Steel Products*, WT/DS248/AB/R, WT/DS249/AB/R, WT/DS251/AB/R, WT/DS252/AB/R, WT/DS253/AB/R, WT/DS254/AB/R, WT/DS258/AB/R, WT/DS259/AB/R, adopted 10 December 2003, paras. 433-456 (A member of a free trade area cannot investigate imports from all sources and then impose a safeguard only against non-FTA imports, without accounting for the possible injury caused by imports from the excluded sources). See further: WTO, Committee on Regional Trade Agreements*, Synopsis of "Systemic" Issues Related to Regional Trade Agreements*, WT/REG/W/37, 2 March 2000, para. 58; WTO, Negotiating Group on Rules, *Compendium of Issues Related to Regional Trade Agreements*, TN/RL/W/8/Rev.1, 1 August 2002, paras. 73-77.

failed to adopt the quantitative restrictions. Article XXIV therefore did not justify Turkey's adoption of those restrictions. The Appellate Body in this decision confirmed that Article XXIV allows for derogations from GATT obligations in general, not just from MFN rights, but subjected any claims for a derogation to a strict necessity test that will justify only measures that would otherwise have prevented formation of the free trade area or customs union.[6] Turkey did not want the extra burden of border controls and noted that textiles and clothing made up about 40% of its trade with the EC. The Appellate Body's test, however, appears to focus only on strict legal necessity.[7]

If the *Turkey-Textiles* decision means that Article XXIV will be interpreted to give strong priority to MFN rights, questions can arise about the treatment of various non-tariff barriers in a free trade agreement. The text of GATT Article XXIV says only that "the provisions of *this Agreement*" shall not prevent the formation of a regional agreement (Art.XXIV:4), but this must refer to most non-tariff barriers to trade in goods, including barriers that are now dealt with more extensively under separate codes and agreements. If these non-tariff barriers are *restrictive* regulations of commerce, then the general principle is that they must be eliminated in internal FTA trade (Art.XXIV:8(b)). If they are not applied to free trade partners, however, outside countries may argue that their MFN rights have been negatively affected. The non-tariff barrier agreements generally do not mention regional trade issues, although the Agreement on Technical Barriers to Trade contains language generally encouraging accessibility and consultations to make any further agreements available to other WTO members.[8]

Concerning trade in services, GATS contains Article V on economic integration agreements in general and Article Vbis on labour market integration agreements. Under Article V, WTO members may enter into integration agreements that provide national treatment[9] for service suppliers from the participating countries, so long as the agreement has substantial sectoral coverage (para.1) and so long as the agreement does not raise the overall level of barriers to external trade in services (para.4).[10]

Similar questions about the rights of non-FTA members could arise over the investment and

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[6]Appellate Body Report, *Turkey - Textiles*, WT/DS34/AB/R, adopted 19 November 1999, para. 63. Note that in the resulting customs union, the EC maintains quantitative restrictions while Turkey does not. In the Appellate Body=s decision, this result still appears to meet the requirement for customs unions in Article XXIV:8(a)(ii) that each member-country apply "substantially the same duties and other regulations of commerce ... to the trade of territories not included in the union."

[7]One commentator has suggested that a test concerning reasonable availability of alternative measures might have produced a different result: Joel P. Trachtman, "Toward Open Recognition? Standardization and Regional Integration under Article XXIV of GATT" (2003), 6(2) J. Int=l Econ. L. 459 at 475.

[8]Agreement on Technical Barriers to Trade, Article 10.7.

[9]Or prohibit new, more discriminatory measures.

[10]The TRIPS agreement also dates from 1995 and the founding of the WTO. According to TRIPS Article 1.1, members may provide in their domestic legal systems a higher level of protection for intellectual property than the level set out in the Agreement. Article 1.3 provides that nationals of other members are entitled to the treatment provided for in the Agreement. Since the Agreement includes national treatment and MFN rights in Articles 3 and 4, Article 1.3 presumably gives a right to any higher level of protection in the domestic legal system. There is no specific provision similar to GATT Article XXIV or GATS Article V setting out requirements for a regional agreement.

competition law chapters of the November 2003 FTAA draft agreement, should the FTAA and the WTO at some point both include provisions in those areas. International investment law is currently regulated by networks of bilateral investment treaties, some of which involve member-countries of the proposed FTAA.[11] Competition law is not so regulated, although some regional agreements have replaced anti-dumping duties with competition law or have special internal competition rules not available to non-members. Any of these differences could potentially have negative effects on non-members. As well, concerns have been expressed over regional agreements with separate dispute settlement systems not available to non-members.[12]

2. **Specific Issues**

a. Special and Differential Treatment

The draft FTAA agreement of November 2003 contains several provisions for special and differential treatment for developing countries.[13] In this respect, the draft agreement differs significantly from NAFTA. Although such provisions are often expressed as "soft law" obligations, they must be interpreted so as to provide real advantages to beneficiary countries, as was the intention.[14]

Special and differential treatment is also available concerning the rules for formation of free trade areas involving developing countries. The *Enabling Clause* of 1979 states that differential and more favourable treatment may be accorded for regional arrangements among less-developed GATT members for the mutual reduction or elimination of tariffs and non-tariff measures.[15] Nineteen regional trade agreements have been notified to the GATT/WTO under the terms of the *Enabling Clause*.[16] Further, GATS Article V:3(a) provides that developing countries shall benefit from flexibility in the criteria for economic integration agreements, particularly

[11]For background, see Linda C. Reif, "The Evolution of Foreign Direct Investment Law: From an Inter-State to a Transnational Dynamic" in *The Auto Pact: Investment, Labour and the WTO*, M.Irish ed. (Boston/Dordrecht/London: Kluwer Academic Publishers, 2003), 193.

[12]See: WTO, Committee on Regional Trade Agreements, *Synopsis of "Systemic" Issues Related to Regional Trade Agreements*, WT/REG/W/37, 2 March 2000, para. 8; WTO, Negotiating Group on Rules, *Compendium of Issues Related to Regional Trade Agreements*, TN/RL/W/8/Rev.1, 1 August 2002, paras. 118-121.

[13]In addition to articles on technical cooperation and assistance, several draft provisions call for special and differential treatment that would take account of both levels of development and size of the economies. See Free Trade Area of the Americas, Third Draft Agreement, FTAA.TNC/w/133/Rev.3, 21 November 2003, Chapter II Article 3(e), Chapter V, Chapter IX Article 12.3, Chapter XIII Article 13, Chapter XV Section B Article 15/9 (alt.), Chapter XVI Article 21, Chapter XVII Article 16.2, Chapter XVIII Article 6, Chapter XIX Article 11, Chapter XX Section C Article 2, Chapter XXI Article 5, Chapter XXIII Section A Article 6 (partial list, many provisions in brackets), online: <http://www.alca-ftaa.org>.

[14]Gustavo Olivares, "The Case for Giving Effectiveness to GATT/WTO Rules on Developing Countries and LDCs" (2001), 35(3) J. World T. 545.

[15]*Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries*, Decision of 28 November 1979, BISD 26S/203, para. 2(c).

[16]WTO, Committee on Regional Trade Agreements, *Interim Report (2003) of the Committee on Regional Trade Agreements to the General Council*, WT/REG/12, 7 July 2003, para. 4. The Committee also reports that 222 agreements were notified under GATT Article XXIV (of which 140 are still in force), while 26 agreements were notified under GATS Article V.

concerning the absence or elimination of discrimination and the prohibition of new or more discriminatory measures. There have been discussions about whether this GATS flexibility refers only to the time for implementation or whether it is, instead, more substantive.[17] If some enhanced flexibility concerning regional agreements applies as well to trade in goods through the *Enabling Clause*, it might entail extended transition times, more generous rules concerning the elimination or reduction of tariffs and non-tariffs barriers in internal trade or possibly a relaxation of the Appellate Body's fairly strict priority for MFN rights in external trade. In the result, the obligations for the establishment of a regional agreement can vary depending on whether the countries involved are developed or developing countries. Acceptance of such differences is necessary in order to provide the benefits of special and differential treatment.

b. Democracy Clause

At the Quebec City Summit in 2001, the leaders endorsed a democracy clause acknowledging that "any unconstitutional alteration or interruption of the democratic order in a state of the Hemisphere constitutes an insurmountable obstacle to the participation of that state's government in the Summit of the Americas process."[18] Similar language appears in the *Inter-American Democratic Charter* adopted in September 2001 concerning participation in the bodies of the OAS.[19] The question arises whether there should be a link between the *Democratic Charter* or some other democracy clause and the proposed FTAA. Proponents of a link point to the example of the *Protocol of Ushuaia on Democratic Commitment in Mercosur, Bolivia and Chile*.[20]

If such a link were established, would the exemptions available in the WTO permit a denial of trade rights based on an unconstitutional alteration or interruption of the democratic order? For trade in goods, GATT Article XX contains general exceptions, but it is difficult to see one that might apply, unless the exception for measures "necessary to protect public morals" (Art.XX(a)) could be interpreted very broadly. Some countries might be able to rely on the security exception in GATT Article XXI for action which a Member "considers necessary for the protection of its essential security interests ... taken in time of ... emergency in international relations" (Art.XXI(b)(iii)). The possible exemptions concerning trade in services are similar and GATS Article XIV mentions both public morals and the maintenance of public order, but it is not clear

[17]See: WTO, Committee on Regional Trade Agreements, *Synopsis of "Systemic" Issues Related to Regional Trade Agreements*, WT/REG/W/37, 2 March 2000, paras. 87-91; WTO, Negotiating Group on Rules, *Compendium of Issues Related to Regional Trade Agreements*, TN/RL/W/8/Rev.1, 1 August 2002, paras. 101-103.

[18]Summit of the Americas, *Declaration of Quebec City*, April 2001, para. 5, online: <http://www.summit-americas.org>.

[19]Organization of American States, General Assembly, *Inter-American Democratic Charter*, OAS Doc. OEA/Ser.P/AG/Res.1 (XXVIII-E-01), 11 September 2001, Articles 19-21.

[20]See: *Protocolo de Ushuaia sobre Compromiso Democrático* , 24 July 1998, <http://www.mercosur.org.uy/espanol/snor/varios/otros/Ushuaia.htm>; *Declaración Presidencial sobre Compromiso Democrático en el MERCOSUR*, 25 June 1996 <http://www.mercosur.org.uy/espanol/snor/normativa/CDEM196.htm>. See discussion in Peter S. Watson, Joseph E. Flynn & Chad C. Conwell, *Completing the World Trading System: Proposals for a Millennium Round* (The Hague: Kluwer Law International, 1999) at 220.

that this would be sufficient (GATS Art.XIV(a), Art.XIVbis.1(b)(iii)). The *Marrakesh Agreement Establishing the World Trade Organization* provides for non-application of agreements between particular Members as determined when either Member joins the WTO (Art.XIII) and also provides for a right to withdraw from the organization (Art.XV), but neither provision seems appropriate. Even the possibility of a waiver of WTO rights is unsatisfactory, as the Marrakesh Agreement assumes that waivers are time-limited and reviewed annually (Art.IX). Should there be a conflict between the WTO and any FTAA that cannot be resolved, the rule favouring the most recent agreement would tend in favour of any FTAA provisions, but this is not a reliable solution.

3. **Conclusion**

What would the inhabitants of the Americas want if we were reconstituting structures today on the idea that states have power only as delegated from the global society in which we as individuals are all members?[21] How would we organize our economic relations to meet the challenges of our region B great disparities in wealth, environments at risk and the burden of public debt overhanging our governments? Would we want corporate codes of conduct for multinational corporations or would we decide to keep labour, human rights and environmental concerns separate from our trade negotiations? Would we want more ability to control capital flows than is now permitted in the *Articles of Agreement* of the International Monetary Fund? Would we want limits on locational incentives for investment to avoid bidding wars? What about immigration rights? Would we establish regional social solidarity and development funds?[22] I am not sure how we would address all these issues, but I doubt that we would now give prominence to trade in goods. The discussions would be wider, as the FTAA negotiations have been wider.

Whatever we decide in the Americas, the regionalism question is about whether these structures could or should be different from how all of us would organize our economic relations as part of global economic society. History gives us Article XXIV and we have developed from that base various structures for enhanced economic exchanges within a group of countries having closer ties than in the general multilateral system. Regional agreements are not necessarily regional these days; many have overlapping memberships and some even involve customs unions as themselves party to a second-level regional agreement. This is not what the drafters of GATT envisaged in October 1947 for Article XXIV. Regionalism is an active force in international economic relations. The provisions of GATT 1994 and other WTO agreements may impose significant and perhaps inappropriate restraints on further development of regional agreements.

[21]Philip Allott, *The Health of Nations: Society and Law beyond the State* (Cambridge University Press, 2002), 399.
[22]See Frank J. Garcia, "Trade and Inequality: Economic Justice and the Developing World" (2000), 21 Mich. J. Int=l L. 975.