Regional Integration According to Article XXIV GATT – Between Law and Politics

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I. Introduction

Regionalism is back! This is, at least, what many studies on this issue assert and what the ongoing European integration process in particular seems to confirm.[1] In reality, regionalism has never gone away since January 1948 when GATT law first started to be applied.[2] The drafters

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1 See, for example, N. Nagarajan, "Regionalism and the WTO: New Rules for the Game?", in: European Commission, Economic Papers No. 128, June 1998, 3.

2 As is known, GATT as such never entered into force but found provisional application by the way of the so-called Protocol of Provisional Application (UNTS Vol. 55 No. 814). See J.H. Jackson, *The World Trading System*, 1997, 39 et seq.
Of course, economic integration is a much older phenomenon than GATT law which cannot be recounted in detail here. See, in this respect, for example, J. Viner, *The Customs Union Issue*, 1950.

A. von Bogdandy and R. Wolfrum (eds.),
Max Planck Yearbook of United Nations Law, Volume 7, 2003, 219-260.

of this agreement have created with article XXIV an open space where Regional Trade Agreements (RTAs) could blossom and enter into competition with the multilateral system. This space was further enlarged through developments on the level of primary and secondary law offering particularly advantageous conditions for RTAs including developing countries.[3]

While cyclical developments in this half century cannot be denied, the trend is clear in the sense of a continuous strengthening of regionalism in a multilateral system which had to adapt to these impulses and to find adequate responses.

In this steady process of proliferation and strengthening of RTAs in an ever-evolving multilateral environment for the last decade an acceleration could be noticed. The most authoritative source to proof this allegation is surely the WTO Secretariat which in a recent paper[4] evidenced that as of March 2002, 250 RTAs had been notified to the GATT/WTO, of which 168 are currently in force.[5] Most interesting is, however, the fact that from 1948 to 1995 exactly the same number of RTAs has been notified to the GATT as in the seven years since 1995 to the WTO (125). Of those 125 notified to the WTO 94 are still in force. Notification procedures take time and have often to pass administrative or political obstacles. If non-notified RTAs are also taken into consid-

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In any case, lacking at that time a general legal framework for multilateral trade and, most of all, a general MFN obligation as imposed afterwards by article I GATT, a comparison of developments before and after 1948 would be of limited value. These earlier developments are, however, of great factual importance as the existence of preferential regimes after World War II and the determination of the participating countries to defend them has had a decisive influence on the outcome of the negotiations on article XXIV.

3 In 1965 Part IV entitled "Trade and Development" was added to the GATT agreement. On 28 November 1979 the CONTRACTING PARTIES adopted the so-called Enabling Clause, a decision entitled "The Differential and more favourable Treatment, Reciprocity and Fuller Participation of Developing Countries" , GATT BISD 26S 1980, 203-205.

4 Regional Trade Integration under Transformation, preliminary draft prepared for the Seminar on Regionalism and the WTO, WTO Secretariat, Geneva, 26 April 2002; http://www.wto.org/english/tratop_e/region_e/sem_april02_e/sem_april02_e.htm

5 Ibid., 3. As of March 2003 this number has risen to 263 of which 180 remain in force.

eration then the number of RTAs in force rises to 243.[6] According to the WTO Secretariat this acceleration can be explained for the first half of the 90s by the uncertainties about the outcome of the Uruguay-Round and by the integration efforts within Europe after the collapse of the COMECON block.[7] For the second half of the 90s the strengthened notification obligations under WTO law can only partly explain this upsurge which does not appear to be only statistical, or, in other words, due to greater transparency. It is more convincing to argue that these developments are more real than apparent and that there are factual reasons to explain these trends convincingly. In fact, in literature many explanations have been expounded.

Paul Krugman has listed the following reasons why regionalism is a natural, almost necessary phenomenon in face of the present status of international trade relations:[8]

- With the number of participants in international trade negotiations ever-increasing, according to the game theory, the costs of non-cooperation are reduced. This assumption would also explain why, once trading blocs following a common policy in external trade relations have formed, interest in cooperation again increases.
- As modern trade negotiations concentrate more on complex non-tariff trade barriers than on rather simple tariff reduction as in past GATT Rounds, multilateral trade negotiations with a great number of participants are far more difficult than negotiations between a smaller number of trading blocs.
- The United States are no longer the determining influence on trade negotiations. The reduction of the number of participants could again facilitate the steering of the negotiations towards a successful end.

Whether the United States has really lost so much power is, however, open to debate. While it is obvious that the influence it had immediately after World War II is no longer present — at being a totally ex-

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6 Ibid., 4. The WTO Secretariat predicts further the coming into existence of another 87 RTAs by 2007. In these numbers neither the accessions to existing RTAs are taken into account nor are the 18 notified Economic Integration Agreements considered. Ibid., note 3.

7 Ibid., 3.

8 See P. Krugman, "Regionalism versus Multilateralism: analytic notes", in: J. De Melo/ A. Panagariya (eds), *New Dimensions in Regional Integration*, 1993, 58 et seq. (74).

ceptional situation – since then there have been ups and downs during the last decade seeing an increase rather than a diminution in economic dominance.

- Unconditional Most-Favoured-Nations treatment (MFN) has lost its appeal because of widespread non-compliance to GATT/WTO obligations. Regionalism can become an alternative to multilateralism, at least so long as rule adherence has been restored.

Baldwin has recently referred to the so-called domino-theory as the main cause for the expansion of RTAs.[9] According to this theory the trade and investment diversion engendered by the creation, extension or deepening of a preferential trade area incites economic actors in non-participating nations to exert "pressure for inclusion".[10] There are always lobbies both for a multilateral approach and for a regional one but the latter, which are directly harmed by the discriminatory practices of trade blocs, usually lobby harder.[11] This theory can explain very convincingly the essentially two-polar regionalisation process where the NAFTA forms one centre, and the EU the other.[12] On the whole, however, these various theories are not mutually exclusive but should be seen as complementary. There is another risk associated with this classification. In fact, by adopting a purely economic perspective one risks ignoring one of the most important motives for regional integration: the political one. We should never forget that political motives were of decisive importance for the creation of article XXIV and it was also of central importance for each integration project of the past. As we will see later, political elements also have to be considered when the permissible extension of regional trade integration has to be assessed.

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9 See R. Baldwin, "A Domino Theory of Regionalism", in: R. Baldwin/ P. Haaparnata/ J. Kiander (eds), *Expanding Membership of the European Union*, 1995, 25-53; id., "The Causes of Regionalism", in: *World Economy* 1997, 865 et seq.

10 Ibid., 878 et seq.

11 See Baldwin, see note 9, 879 et seq. for a detailed analysis of this asymmetric lobbying process.

12 Interestingly, the Asian continent was a far harder place for integration initiatives than Europe or the Americas. A leading trading nation as Japan has not even joined one single RTA. See, in this context, H. Saburi, "The GATT/WTO and Regional Integration", *The Japanese Annual of International Law* 44 (2001), 60 et seq. (61).
At a closer look, however, this situation is another confirmation of the paramount importance of politics in regional integration as political cohesion on the Asian continent is arguably extremely low.

Before we enter into a detailed discussion about the various concepts that come into consideration here, we should perhaps set the focus right. Usually we associate regionalism with issues that happen at the subnational level. Economic regionalism, however, is different, as it concerns, mainly, phenomena of transnational relevance. This different perspective can be easily explained if we consider that the reference point for International Economic Law is not the national order but the mutilateral, and potentially the universal one. In this light, economic regionalism turns again to a second stage with regard to the primary objective, the multilateral system. As this issue is totally different from that of national regionalism it is also submitted that the values associated with economic regionalism are of a diverse nature.

On a national and even on the EU level regionalism is considered predominantly as a positive development.[13]

It is an important expression of the principle of subsidiarity, a necessary counterbalance against centralism and a purely state-oriented perspective. It fosters the participation of broader parts of the society in the democratic decision-making process and it allows for better consideration of local realities in the spending of public funds. Through the transnational cooperation of subnational regions, regional necessities can be taken into account even on a level transgressing national boundaries.

The overall attitude towards economic integration is, on the other hand, mixed. Economic regionalism is often seen as a second best solution which should be resorted to only where the first best solution, multilateralism, is not attainable. There are even outright opponents of economic regionalism who maintain that this tendency is endangering the multilateral system or even the principle of free trade altogether.[14] Others are of the opinion the economic integration can be conducive to the further liberalisation of trade as it may have an experimental function, it may show the way for further liberalisation attempts and it may

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13 It may here suffice to mention the great importance attributed in the European politic discussion to the principle of subsidiarity and the ever louder call for a "Europe of Regions". Although these calls had so far only limited practical success it cannot be denied that they are widely seen as legitimate political goals.

14 RTAs are sometimes defined as "stumbling stones" on the way towards a more liberal international trade system. See also note 54 and accompanying text.

engender a competitive process where market liberalisation is the ultimate goal.[15]

The International Economic Order and — in particular — article XXIV GATT, the most important legal provision in this regard, reflects very impressively the broad dissent and conflict of opinion prevailing in this field. We will see that this provision is in many ways inconclusive. Its underlying tendency may be favourable towards regional integration zones but the main reason for this attitude seems to lie in the fact that regionalism as such cannot be impeded and therefore the primary goal should be to rein in its most detrimental effects.

II. Forms and Dimensions for Modern Economic Integration

So we have learnt that economic regionalism — understood in its traditional sense — is mainly a transnational phenomenon and we have anticipated that there are rather contradictory attitudes towards this reality. Before proceeding to a detailed analysis of the legal problems resulting from economic integration we should first try to present and to clarify some basic concepts through which regionalism presents itself in reality.

There are several classification systems which attempt to grasp the broad variety of regional integration zones. A first classification attempt could result in a hierarchy of various forms of integration according to their scope, intensity and deepness. In this sense the following order could be identified:

Preferential Trade Agreement, Free Trade Area, Customs Union, Common Market and Monetary Union. It should be immediately stated that this classification in practice is not as neat as it might seem at first glance.

Starting with the preferential agreements it should be pointed out that this concept has been used as an over-arching category which

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15 The theory of the "domino effect" mentioned above also contradicts the "stumbling stone" - thesis – perhaps not in a static view but surely in a dynamic one as it predicts an ever greater scope of application for the *inter-se* liberalization agreed upon within the RTA.

should comprise the subsequent ones.[16] With regard to this proposal it suffices to say that the coining of a concept which is to encompass all forms of regional integration would surely be beneficial for the discussion of the whole subject, but this advantage must be balanced against the drawback of interfering with another usage of this term which is well-established and appears to be worth maintaining. In the following we will therefore keep to the traditional usage of this term according to which by a preferential agreement one country opens its borders to other countries for a certain range of goods (and maybe services) but there is no general liberalisation scheme. Preferential trade agreements are clearly trade diverting and the drafters of the GATT aimed particularly at outlawing such agreements as they are, from a global perspective, welfare-reducing.[17] On the other hand, they wanted to legalize Free Trade Areas and Customs Unions. The rationale lying beneath this attitude was rendered explicit by *Clair Wilcox*, then the Director of the Department of International Trade Policy in the book, *A Charter for World Trade*, published in 1949:

"A customs union creates a wider trading area, removes obstacles to competition, makes possible a more economic allocation of resources, and thus operates to increase production and raise planes of living." "A preferential system, on the other hand, retains internal barriers, obstructs economy in production, and restrains the growth of income and demand. It is set up for the purpose of conferring a privilege on producers within the system and imposing a handicap on external competitors." "... a customs union is conducive to the expansion of trade on a basis of multilateralism and non discrimination, a preferential system is not".[18]

This distinction is categorical and appears to be very clear even though it is not so evident what its basis is. We will have a look at them towards the end of this paragraph.

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16 See A. Panagariya, "The Regionalism Debate: An Overview", *World Economy* 22 (1999), 477 et seq., referring to J. Bhagwati, "U.S. Trade Policy: The Infatuation with Free Trade Areas", in: J. Bhagwati/ A.O. Krueger (eds), *The Dangerous Drift to Preferential Trade Agreements*, 1995.

17 In fact, it can be assumed that previously trade was done with the most cost-efficient producer while the introduction of trade preferences is distorting the relative prices giving false signals to the economy thereby reducing national and global welfare.

18 C. Wilcox, *A Charter for World Trade*, 1949, 70 et seq.

In line with this reasoning, article XXIV GATT refers only to two forms of regional integration, Free Trade Areas and Customs Unions.

What are Free Trade Areas?

Para. 8 lit. b) of article XXIV defines them as "a group of two or more customs territories in which the duties and other restrictive regulations of commerce are eliminated on substantially all the trade between the constituent territories in products originating in such territories".

For a Customs Union to be in line with GATT/WTO law para. 8 lit. a) states the following conditions:

- First of all, the same condition as with a Customs Union applies according to which "duties and other restrictive regulations of commerce [...] 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".

- Secondly, "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".

Basically, a Customs Union represents a more developed Free Trade Area where the member countries apply a common external tariff.

In principle, GATT law does not know further forms of regional integration. Article XXIV mentions also so-called "interim agreements". These are nothing more than agreements which do not yet fulfil all the requisites for a fully-fledged Free Trade Area or Customs Union but which should, in the end, lead to such a RTA. The underlying rationale is that it is hardly possible for an integration endeavour to become fully operative from scratch. Allowance must be made for a transitory agreement in which the necessary adaptions to the national legal and economic system can be undertaken. The problem is that interim solutions tend to be very long-lasting and resilient thus becoming in fact a-discriminatory-preference agreement. In order to avoid this para. 5 lit. c) of article XXIV requires any interim agreement to be furnished with a plan and schedule for the formation of a Free Trade Area or a Customs Union within a reasonable length of time. This expression has been clarified to state that this period "should exceed 10 years only in exceptional cases".[19]

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[19] See the Understanding on the Interpretation of article XXIV of the GATT 1994 agreed upon during the Uruguay Round.

When we ask why GATT law does not address further forms of RTAs we must bear in mind that article XXIV was drafted in the immediate aftermath of World War II when forms of higher integration where not foreseeable — at least not as a real challenge to the multilateral system. In various parts of the globe and, especially, in Europe, however, international cooperation and integration has assumed, over the years, an astonishing intensity. The creation of the EC as a Customs Union was a rather slow process. It was planned that the "transitional period", during which the EEC treaty was not fully operative, should end on 31 December 1969. The completion of the Customs Union was anticipated for 1 July 1968. It was, however, always planned that the EEC should not only be a Customs Union but become a Common Market.

The Common Market concept was based on three pillars:[20]

- the establishment of "an internal market characterized by the abolition, as between Member States, of obstacles to the free movement of goods, persons, services and capital";[21]
- "a system ensuring that competition in the internal market is not distorted"[22] and
- "a common commercial policy".[23]

The common market has been defined as "a market in which every participant within the Community in question is free to invest, produce, work, buy and sell, to supply or obtain services under conditions of competition which have not been artificially distorted".[24]

The concept of the Common Market has been supplemented by that of the Internal Market. According to article 3 (c) an Internal Market is characterized by the elimination of all restrictions for the free circulation of goods, persons, services and capital. According to article 14 ECT[25] "[t]he internal market shall comprise an area without internal frontiers in which the free movement of goods, services and capital is ensured in accordance with the provisions of the Treaty". The launch-

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20 See P.J.G. Kapteyn/ P. VerLoren van Themaat, *Introduction to the Law of the European Communities*, 1998, 122.

21 Article 3 (c).

22 Article 3 (g) and arts 81 et seq.

23 See article 3 (b) and 131 ECT.

24 See note 20, 123.

25 Formerly article 7 (a) and previously article 8 (a) EEC.

ing of this concept in 1985[26] has given much impetus to the integration process and the date of 1992, when the internal market should have been completed, seemed to be of almost magical importance. This goal was not fully achieved by that date and this was no wonder as a real internal market between sovereign countries in an economy with continuos changing technologies requires relentless efforts.[27] There can be no doubt, however, that the achievements in this field are formidable.

While the definition of the Internal Market given by article 3 (c) and article 14 ECT seems to refer to a concept of lesser dimensions than that of a Common Market developed by the doctrine, this finding does not correspond to the factual application of the former concept through jurisprudence and legislative practice. As it does not appear to be possible to draw a clear line between these two concepts it can be argued that both are widely identical in content but the internal market concept has been conceived in order to revitalize an approach which has lost its appeal over the years, primarily because of the obstinate resistance the ongoing integration process had to face.

The Internal Market was not the end of the story. According to article 4 ECT "[...] the activities of the Member States and the Community shall include, as provided in the Treaty and in accordance with the timetable set out therein, the adoption of an economic policy which is based on the close coordination of Member States' economic policies, on the internal market and on the definition of common objectives, and conducted in accordance with the principle of an open market economy with free competition". Further integration steps could still be in the offing as time and again proposals for the creation of a federal model for the integration of Europe are presented. The realisation of these models, though being improbable for the time being, would mark an extreme development of an integration process, which since 1957, has continuously searched for other limits of article XXIV. Of course, once Member States have lost their sovereignty we would no longer be in the ambit of a regional integration model according to article XXIV GATT but, instead, be confronted with a single unity, a single Member State whose internal constitutional divisions would be widely irrelevant to

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26 See the Commission's White Paper "Completing the Internal Market", COM (85) 310 of 14 June 1985 which led to the Single European Act of 1986.

27 See P. Craig/ G. de Búrca, *EU Law*, 1998, 1116, pointing at the fact that the internal market is not a once-for-all, static objective.

GATT law, with the exception of article XXIV:12 which states the following:

"Each contracting party shall take such reasonable measures as may be available to it to ensure observance of the provisions of this Agreement by the regional and local governments and authorities within its territories".

This is the only provision of GATT which makes an explicit reference to what has been called in the introductory part "subnational regionalism".

What has been depicted here as a continuum of integration forms with rising integration intensity, in practice often presents itself in a different way. It suffices to point at the European Economic Area, *per se* a Free Trade Area but which in reality is more deeply integrated than many of the existing Customs Unions.

What is the reason for this "crumbling hierarchy"? In 1947 when the GATT text was drafted, the main obstacles to trade were tariffs; to liberalize international trade meant to reduce tariffs. What later became the major target of trade liberalisation efforts was then regarded primarily as an expression of the internal powers of sovereign states. As long as tariffs where of such paramount importance no sensibility could develop for qualifying such norms as barriers rather than as legitimate national regulations. As is known this changed with the declining tariff levels and at the Tokyo-Round (1973-1979) non-tariff trade barriers became a more important negotiating item than tariffs themselves. This is even more true for the present day where the average tariff level for industrial goods amounts to not more than 3.9 per cent. The real trade barriers are now regulatory.[28] As tearing down regulatory barriers is a much more delicate issue than the reduction of barriers, consent of this kind could be reached far more easily in regions like that one where the EEA operates which was and still is home to vigorous and successful integration attempts and where member countries share common values on a very broad scale.

How should these integration forms "of a higher degree" be qualified from a GATT/WTO perspective? This is difficult to assess. In this field GATT law has not changed since 1947 and even the understanding on the interpretation of article XXIV remains silent in this regard. Also

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28 See P. Holmes, "The WTO and the EU: Some Constitutional Comparisons", in: G. de Búrca/ J. Scott, *The EU and the WTO, Legal and Constitutional Issues*, 2001, 59 et seq. (68).

economic theory has so far not given an unequivocal answer to this question. Does this mean that GATT law has become inadequate for judging RTAs? Not necessarily. The main aim of the relative provisions is still to counter effectively preferential agreements which are openly trade diverting. In this article XXIV succeeds very well already by its preventive force. In fact, notwithstanding all the interpretative difficulties to which this provision gives rise, it conveys the message that RTAs which are openly trade-diverting are not tolerated by GATT/WTO law.[29]

This is, however, not yet the key to the ongoing success of a norm which has been drafted in a time when the intensity and the direction of the regionalisation process could not even remotely be foreseen. Why does it still make sense to draw such a clear line between preferential agreements providing only for imperfect discrimination and all the remnant RTAs which are continuously evolving towards ever-higher degrees of discrimination?

In fact, it has been argued that from the viewpoint of the Most Favoured Nation principle a RTA is a discriminatory agreement and therefore a preferential agreement, as an imperfect RTA should not be regarded as worse than a perfect RTA where discrimination is more pronounced.[30] According to this line of thought, the modern forms of "deep integration" should be given special attention while agreements with lesser integration intensity could perhaps be considered with more leniency.

There are, however, good reasons to uphold the traditional view on this issue:

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29 An open challenge to GATT/WTO law would be contrary to the interests of each individual Member State as it would undermine the authority of the institution and may lead to countermeasures. The particularities of law enforcement in public international law apply fully to this field. See, in general, on this subject L. Henkin, *How Nations Behave*, 1979.

30 *Kenneth Dam* has expressed this consideration in 1963 the following way: "Since the tariff reduction inherent in such a preferential arrangement might be considered to be a movement towards free trade, albeit not so dramatic as that produced by a customs union or free-trade area, and since such a preferential arrangement by definition involves less discrimination against non members than a customs union or free-trade area, the justification for proscribing such arrangements absolutely is not clear." See K.W. Dam, "Regional Economic Arrangements and the GATT, the Legacy of a Misconception", *U. Chi. L. Rev.* 30 (1963), 615 et seq. (633).

First of all, permitting preferential agreements in the sense of only partially integrated RTAs could lead to agreements which are predominantly trade-diverting as the forces representing these interests may be prevailing over the political forces representing trade-creating interests.[31] The more extensive the coverage of a RTA is, the more it can be assured that also trade creation happens and that, finally, this element will prevail.

The second reason why the traditional distinction appears to be still valid can be found in the fact that article XXIV discriminates basically between RTAs that seem to be strong enough so that they cannot be impeded any way and those which seem to be not so resilient. While the first category of RTAs could become a real danger for the multilateral system if not subjected to some sort of at least generic control system, with regard to the latter group the GATT/WTO seems strong enough to prohibit them altogether. Without doubt, Common Markets and other RTAs which have successfully also tackled regulatory tariff barriers pertain to the group of highly integrated RTAs for which it is usually easy to pass the admissibility test. With regard to these RTAs it is in the interest of the whole GATT/WTO system to ensure the appearance that control over them is maintained even if in some cases this is nothing more than an illusion.

As will be shown in the following section a central condition for a RTA to correspond to GATT/WTO law is the integration of substantially all the trade. Those RTAs that fulfil this demanding requisite can

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31 See, in this context, *Robert Hudec*, comment on M. Finger, "Gatt's Influence on Regional Arrangements", in: J. De Melo/ A. Panagariya (eds), *New Dimension in Regional Integration*, 1993, 155:
"In addition, once governments are allowed to select some products and not others, political forces will inevitably exert enormous pressure to choose trade-diverting preferences first. Trade-diverting preferences are the ones that result in the greatest net political gain for governments; the political gains arise from pleasing local producers who displace third-country producers, while political losses are entirely avoided because third-country producers do not vote".
In the same vein also *F. Roessler*, "The Relationship Between Regional Integration Agreements and the Multilateral Trade Order", in: K. Anderson/ R. Blackhurst (eds), *Regional Integration and the Global Trading System*, 1993, 311 et seq. (314). It is, of course, not possible, to predict such a development with absolute certainty but the scenarios cited appear realistic. See also J.H. Mathis, *Regional Trade Agreements in the GATT/WTO*, 2002, 113 et seq.

be considered as the expression of a clear underlying will by the participating states which by concluding these agreements pursue not only economic goals but also strictly political ones. In this sense it is not really surprising that the provisions of article XXIV have not been adapted to the new reality characterized by the formation of highly integrated zones with possibly far larger trade diverting effects than those deriving from traditional Free Trade Areas and Customs Unions.[32] It is not up to the GATT/WTO system to second-guess these political decisions even if the price for this restraint is further imperfections in the multilateral system. This price, however, will not be too high as the conditions, exposed in detail in the following paragraph, are still rigorous. Subsequently, it will be shown that this rigour, in order to be credible, requires resolve when it comes to the enforcement of these rules. Recently, the WTO dispute settlement organs have demonstrated this resolve in a very pronounced form.

III. The Content of Article XXIV[33]

Article XXIV is an exception to the Most-Favoured-Nation-principle of article I GATT according to which "any advantage, favour, privilege or immunity" granted by any contracting party to any product originating from other contracting parties shall be extended to like products originating from other contracting parties. Essentially the MFN principle in the ambit of the GATT/WTO system leads to the multilateralisation of preferences accorded bilaterally. Article XXIV prevents this multilateralisation from operating in a circumscribed setting.

What are the conditions, article XXIV poses to regional integration?

Para. 4 of article XXIV spells out the general function attributed to RTAs. This is to "facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories". This general aim has later been specified by *Jacob Viner*

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32 See P. Krugman, *EFTA and 1992*, EFTA Occasional Paper No. 23, who argued that the EC single market programme had detrimental effects on EFTA-based firms.

33 See in this context also, for example, H. Steinberger, *GATT und regionale Wirtschaftszusammenschlüsse*, 1963; R.S. Imhoof, *Le GATT et les zones de libre échange*, 1979; P. Hilpold, "Regionale Integrationszonen und GATT – Die Neuerungen der Uruguay-Runde", *RIW* 25 (1993), 657 et seq.

with the request that the trade creating effects of regional integration should prevail over the trade diverting effects of such initiatives.[34]

Before *Viner's* seminal contribution to integration theory, or, if we see his research work as an interpretation of the new GATT philosophy on RTAs, before the creation of this law, the distinction between trade creation and trade diversion could hardly come to the mind of the observer of integration movements as a multilateral framework protecting free trade as a value *per se* was lacking and the attention always focussed on the effects on trade in the integration area itself. With the attention shifting from the regional to the multilateral level it was a natural consequence that regionalism should be considered a positive phenomenon only as long as its positive effects on trade, taking into consideration also the situation of non members, should prevail.

On an abstract level, the soundness of this approach could hardly be contested if non-discriminatory free trade on a multilateral level is the ultimate goal to be pursued.[35] The devil, is, however, as always, in the detail. How can the prevalence of the trade creating effects of regional integration over the trade diverting ones be guaranteed by a legal text which should potentially be suited for global application over an undefined period of time? It is evident that such an endeavour can be successful only if the drafters of the relevant provisions can rely on a settled theory to which they can give expression in a clear and succinct way. The principle thereby stated should be applicable to differing situations not foreseeable in every detail at the moment the relevant norm is being drafted. It does not seem that article XXIV is meeting these demands. Not only is this provision poorly drafted. It is neither easy to discover an underlying settled economic theory on which the

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34 See also, for example, J. Huber, "The practice of GATT in examining regional arrangements under article XXIV", *Journal of Common Market Studies* 19 (1981), 281 et seq. (294). *N. Nagarajan*, on the other hand, contests in his paper "Regionalism and the WTO: New Rules for the Game", Economic Papers No. 128, June 1998, 8 that article XXIV is about distinguishing between trade-creating and trade-diverting arrangements, pointing at the fact that GATT pre-dates Viner's book of 1950. It could, however, be argued that Viner's aim was not to establish a new rule but to interpret the existing rules as set out in article XXIV.

35 That free trade is, according to mainstream economics, still the superior ideal for the conception of national foreign trade law notwithstanding that many rival positions have been formulated during the last two centuries has aptly been shown by M. Trebilcock/ R. Howse, *The Regulation of International Trade*, 1999, 7 et seq.

evaluation process should be based,[36] nor is it clear how the conditions set for a RTA in order to respond to GATT/WTO law should be implemented.

The only details about how the prevalence of the trade creating effects over the trade diverting ones shall be obtained for Free Trade Areas and Customs Unions respectively are furnished in paras 5 and 8 of article XXIV. Para. 5 aims at protecting the interests of WTO members remaining outside a RTA. For those countries the duties and other regulations of commerce imposed after the formation of a Customs Union shall not, on the whole, be higher than before. In the case of the formation of a free-trade area this comparison refers to the duties and other regulations of commerce imposed by each individual member of the FTA since there are no common tariffs. There has always been much disagreement on how to interpret this provision. First of all, it was not clear whether the applicable or the applied tariffs should be compared. While the applicable tariffs are those resulting from tariff bindings, in practice the applied tariffs are often far lower. Common sense would suggest that the latter should be referred to as they alone matter, but there was strong opposition to this approach, first of all by the EEC since for the calculation of the original six members of the EEC customs union, the Italian bound tariff was used even though the respective rate had never been applied.[37] In the meantime, in the 1994 Understanding on the Interpretation of article XXIV, it has been clarified that for the assessment of Customs Unions the applied tariffs are relevant. Though there is a strong case for an extension of this principle to FTAs, until now, no explicit statement in this sense can be found in WTO law.

For Customs Unions a further question needing clarification regarded the way the general incidence of the duties and other regulations of commerce applicable before and after the formation of the Customs

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36 See, in this regard, for example, the statement by R. Pomfret, "The Theory of Preferential Trading Arrangements", *Weltwirtschaftliches Archiv* 122 (1986), 439 et seq. (460): "The theory of preferential trading has been one of the more disappointing branches of post war economics. That is despite Viner's great insight about the ambiguity of welfare effects, which is led of the theory of second best."
See also, more broadly, R. Pomfret, *The Economics of Regional Trade Arrangements*, 1997.

37 See N. Nagarajan, *Regionalism and the WTO: New Rules for the Game?*, European Commission, Directorate-General for Economic and Financial Affairs, Economic Paper No. 128, June 1998, 14.

Unions should be calculated. For a long it has been argued that a meaningful comparison should take into account the trade volume under the single tariff lines and therefore weighted average tariff rates should be referred to. This position was finally adopted by the Understanding on the Interpretation of article XXIV, 1994.

In para. 8 we find the most important condition of all for the creation of a regional integration zone: it has to comprise substantially all the trade between the member countries. For Customs Unions the common external tariff has to consist of the application of "substantially the same duties and other regulations of commerce" to trade with countries not included in the union.[38]

The attempt to quantify this condition has been the subject of much controversy, whereby the various proposals ranged from 51 to 99 per cent.[39] It seems that a range between 80 to 90 per cent has found the broadest consensus but it must be stated that a quantitative criterion alone cannot fully do justice to this condition. This condition rather requires also the respect of so-called qualitative elements in the sense that no major sector of the economy should be excluded from the intra-RTA liberalization scheme.[40] Traditionally, problems arose in this field with trade in agriculture where the most obstinate protectionist forces regularly are at work. But even on the occasion of the examination of the EFTA agreement which excluded the predominant part of agricultural products from liberalization, the GATT contracting parties could not find an agreement on how to assess this situation.[41]

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38 Article XXIV, para. 8 lit. a) ii).

39 See Hilpold, see note 33, 663. The 51 per cent mark has been advocated by G. Roselieb, "Die rechtliche Stellung der europäischen Wirtschaftszusammenschlüsse (Montan-Union, EWG, EFTA) zum GATT", *ÖZöRV* 2 (1961), 27 et seq.

40 GATT BISD 9S, 1961, 83 et seq.

41 The EFTA Member States argued that the "substantially-all-the-trade" condition in article XXIV was appositedly introduced to allow for the exclusion of the agricultural sector in view of a possible participation of the United Kingdom in a European free trade area. Furthermore the wording of this provision required the liberalization of substantially all the trade and not of the "trade in substantially all the products."
"There was [...] a divergence of view regarding the justification for including, in estimating the amount of trade within the free-trade area to be freed from barriers in terms of article XXIV, the trade in agricultural products were freed in the case of one member State only. In the time at its disposal, the Working Party was unable to reach agreement concerning the inter-

The main reason why a clarification of these contentious issues in the interpretation of article XXIV could not happen in the GATT working groups established to evaluate these RTAs can be found in the fact that these groups worked on the basis of the consensus principle, the central decision making criterion for the whole GATT law, which is not very well suited to find agreed solutions if interests of fundamentally different nature have to be considered.[42] It comes therefore as no surprise that the working parties formed for the evaluation of the many RTAs notified to the GATT came to no conclusion since to the GATT conformity this integration project was negligible.[43] As is known, article XXIV, despite all its shortcomings and lacunae which became more and more evident over the decades, after the Havana Conference remained substantially unchanged not only until the end of the days of GATT 1947[44] but was brought again to life in WTO law. To the WTO Members it appeared to be sufficient to recall the basic principle cited before according to which tolerance towards RTAs required a balancing between positive and negative trade effects of regional integration. This was, however, not a complacency towards past events in this area but rather an admonition that this balancing should be taken seriously. Consequently, in the Understanding on the Interpretation of article XXIV adopted at the end of the Uruguay Round it was reaffirmed:

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pretation which should be given to the relevant provisions of article XXIV."

See GATT L/1235 of 4 June 1960, GATT BISD 9S/70, paras 48-49, 51, 54 and *Analytical Index, Guide to GATT Law and Practice*, 1994, 767.

42 Despite the discriminatory nature of RTAs these agreements have always found strong support by a consistent number of GATT Contracting Parties. The reasons varied. They ranged from a politically motivated support for the European integration initiatives to the hope to foster progress in developing countries concluding inter-se agreements.

43 Empirical tests have shown that on the whole only in five cases it was possible to find a decision by consensus. The most important one regarded the Customs Union between the Czech and the Slovak Republic of 1993 (GATT L/7212 of 30 April 1993, Add. 1 of 12 May 1993 and GATT L/7501 of 15 July 1994). See P.C. Mavroidis, "Judicial Supremacy, Judicial Restraint, and the Issue of Consistency of Preferential Trade Agreements with the WTO: The Apple in the Picture", in: D.L.M. Kennedy/ J. D. Southwick (eds), *The Political Economy of International Trade Law*, 2002, 583 et seq. (587) referring to J. Schott, "More Free Trade Areas?", in: J. Schott (ed.), *Free Trade Areas and U.S. Trade Policy*, 1 et seq. (25).

44 See *GATT Analytical Index*, see note 41.

> "[...] that the purpose of such agreements should be to facilitate trade between the constituent territories and not to raise barriers ...; and that in their formation or enlargement the parties to them should ... avoid creating adverse effects on the trade of other Members".

In the Declaration adopted at the Singapore Ministerial Conference of 1996 we find the prudent statement that "[regional agreements] *can* promote further liberalization and *may* assist least-developed, developing and transition economies in integrating into the international trading system.[45]"

At the same time the Ministers stated that "[t]he 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."

They went on to "reaffirm the primacy of the multilateral trading system, which includes a framework for the development of regional trade agreements" and they renewed their "commitment to ensure that regional trade agreements are complementary to it and consistent with its rules."[46]

On the whole, these statements are the expression of a rather cautious approach towards regionalism and the very basis of this caution seems to be the uncertainty about the real impact of regionalism on the multilateral system, especially in the longer run. Far clearer than in article XXIV, the WTO members, with half a century of experience on this issue behind them, point out that the multilateral system must always enjoy priority.

If the reading of the relevant provision in the Singapore Ministerial Declaration might give the impression that on balance a slightly positive attitude towards regionalism prevailed among the ministers, this impression might be due to the confidence the Ministers put into the operating of the newly established Committee on Regional Trade Agreements (CRTA, see below) which should bring new rigour to the procedure for the examination of RTAs.

The Understanding on the Interpretation of article XXIV resulting from the Uruguay Round improved this picture somewhat as thereby

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45 Emphasis added.

46 See para. 7 of the Declaration.

important clarifications to some long-contested issues could be obtained.[47] The most important results were the following:

- The evaluation of the general incidence of the duties and regulations of commerce applicable 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. Thus, a far more realistic picture of the potential trade deflection generated by the creation of a Customs Union could be achieved.
- The application of the general dispute settlement provision on issues of regional trade integration was confirmed.[48] Thereby it was acknowledged that the conclusion of RTAs was not only a political question but remained an issue which should be assessed by a judicial organ on legal terms. Without doubt, the judicialization of the evaluation process added rigour to it. On the other hand, with clarifications on important elements of this evaluation process still lacking, this also meant that it was up to the dispute settlement organs to specify them. True, even under GATT law there were several attempts to obtain further clarifications about the meaning of article XXIV but under GATT law none of these procedures lead finally to an adopted report.[49] As will be shown afterwards it was not before the Turkey-Restrictions on Imports of Textile and Clothing Products case[50] that this happened and it was more than natural that the large interpretative leeway would, however it was used by the WTO dispute settlement organs, lead to considerable criticism.

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47 On the specific function of this provision of the Dispute Settlement Understanding to strengthen article XXIV see also J.H. Jackson, *The World Trade Organization: Constitution and Jurisprudence*, 1998, 55.

48 Para. 12 of the Understanding. This appears to be a further confirmation of the supervisory role of the WTO dispute settlement system recently emphasized by Y. Iwasawa, "WTO Dispute Settlement as judicial supervision", *JIEL* 5 (2002), 287 et seq.

49 See EEC-Tariff Treatment of Imports of Citrus Products from Certain Countries in the Mediterranean Region, GATT L/5776 of 7 February 1986; EEC Member States' Imports Regimes for Bananas, Panel Report WT/DS32/R of 3 June 1993; EEC – Member States' Import Regimes for Bananas, Panel Report WT/DS38/R of 11 February 1994.
As it is known, under GATT law the adoption of a Panel Report required consensus among the CONTRACTING PARTIES which was hard to achieve in such a contentious matter as the one here at issue.

50 Panel Report WT/DS34/R of 31 May 1999; Report of the Appellate Body WT/DS34/AB/R of 22 October 1999, AB-1999-5.

With regard to the overall political assessment of RTAs the most important development of the post-Uruguay-Round period concerned the introduction of the WTO Committee on Regional Trade Agreements.[51] By the establishment of this Committee it was hoped to render the evaluation of RTAs more transparent, thereby enabling it to develop common standards which should also provide for more legal certainty in this area. Until now these hopes have remained largely unfulfilled since standard-setting by a political body operating in a very considerate diplomatic environment characterized by only vague legal criteria has proved to be a difficult task.

Above all, it must be recalled that decision making in this field follows a totally different path from that with regard to dispute settlement. While the negative consensus rule assures nearly automatic adoption of Panel reports by the Dispute Settlement Body, outside this area the still dominant positive consensus rule makes it rather difficult to pass a verdict on a confrontational issue.[52] As the CRTA itself admitted in its report to the General Council in 1998 on the operation of this body the lack of consensus regarded not only the factual evaluation of single integration projects but the far more difficult issue of the interpretation of the applicable rules.[53]

IV. First Conclusions about Regional Integration in GATT/WTO Law

Before we deal with the latest developments in the endeavour, now lasting several decades, to find a proper place for regionalism in the multilateral system and to determine both its scope for further development and its borders which may not be transgressed, an attempt to

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51 This organ was created by a decision of the WTO General Council on 6 February 1996. See also under note 60.

52 See Mavroidis, see note 43, 591.

53 See G. Fisch, "Regionalism and Multilateralism – Side by Side", in: K.G. Deutsch/ B. Speyer (eds), *The World Trade Organization Millennium Round*, 2001, 213 et seq. (217).
In recent literature the hope has been voiced that the analytical tools to assess the phenomenon of regional integration will be greatly improved over the next years. See A. Krueger, "Are preferential trading arrangements trade liberalising or protectionist?", *Journal of Economic Perspectives* 13 (1999), 105 et seq.

which the WTO dispute settlement organs have lately given an important contribution, a short summary of the fundamental position GATT/WTO law takes towards regionalism and the conditions it sets to this phenomenon might be helpful to grasp the enormous challenge the WTO dispute settlement was faced with when asked to provide for further clarification in this area.

We have seen that GATT/WTO law in principle, takes a positive attitude towards regional integration, partly because this phenomenon cannot be impeded anyway, and partly because this corresponds to strongly felt interests by several WTO members which, confronted with an option, might decide against the multilateral system. On the whole it appears safe to say that the drafters of GATT/WTO law have seen in RTAs more a building block than a stumbling stone[54] for the architecture of a multilateral free trade system and this assumption has been proven correct by the developments. While recognizing that trade integration has both positive and negative effects in the sense that there are both trade creating as trade diverting consequences the main intent of GATT/WTO law has been to ensure that the positive, trade creating effects of RTAs should prevail. In the preceding paragraph it was shown that this result was to be obtained by the "substantially-all-the-trade" criterion as well as by the obligation that tariffs and regulations of commerce with regard to non-participating countries should not become more restrictive than they were before. It was also shown that the clarification of these conditions was a difficult process which is in part still ongoing. In any case these conditions are far from being sufficient to guarantee that the general purpose of RTAs, set out in para. 4 of article XXIV, "to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories" would be really attained. At the most the fulfilment of these conditions provides *prima facie* evidence that the integration process goes in the right direction, but we are far away from a final assessment of the overall economic impact resulting from the creation of a RTA. In fact, in an *ex-ante*-evaluation of an integration project there are so many elements to be considered that it is often nearly impossible to quantify the real impact on trade of such an endeavour. As has been re-

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54 This famous comparison has been coined by J. Bhagwati, *The World Trading System at Risk*, 1991.

cently shown[55] the following elements can influence changes in trade volumes in the wider context of the creation of a RTA:

- trade creation and diversion existing within the union;
- changes in the flows of capital and labour;
- changes in the general level of prices;
- changes in exchange rates.

Furthermore, short-term static effects of regional integration have to be distinguished from dynamic effects showing up in the longer term. Thus, while at the moment of the creation of a RTA the trade diverting effects may prevail, the growth stimulus engendered by the formation of an integration area may, in the longer run, attract further imports thereby compensating for former losses in trade by non-members.[56]

Changes of trade flows after the creation of a RTA may also depend on other factors such as changes in the terms of trade, welfare gains as a consequence of economies of scale, shifts in consumer preferences or industry competitiveness. Finally, regard has to be taken to business cycles and to whether there is world-wide a situation of growth or slowdown. In this context, account must also be taken of the fact that the causalities may operate in two ways as the creation of RTAs may have positive or negative consequences on the growth of the world economy.[57]

It stands to reason that the isolation of the effects of regional integration from all the factors just mentioned is an almost impossible task and in any case the theoretical instruments needed for this task are not yet available. As a consequence, it should not come as a surprise that opinions in academic literature on how to judge the effects of RTAs are divided and this is the case even for European Integration where reliable statistical data as well as a wealth of econometric studies should be easily available. In fact, some authors see in the context of European Integration the trade creating effects as prevalent, others the trade diverting ones.[58] There is more consensus with regard to the broad net of

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55 See G. Marceau/ C. Reiman, "When and How Is a Regional Trade Agreement Compatible with the WTO?", *Legal Issues of Economic Integration* 28 (2001), 297 et seq. (305 et seq.).

56 Ibid.

57 Ibid.

58 Among the first group *Balassa*, *Robson* and *Winters* can be found, among the second *El-Agraa* and *Pomfret*. See P. Moser, "Reasons for Regional In-

FTAs concluded by the European Community. In view of the, in part problematic, treatment of agriculture within this agreement the prevalence of trade diverting effects seems most probable.[59] These agreements have, however, mostly a development background or have been concluded in the framework of an approaching process which in many cases should finally lead to membership within the European Union. In part, they are typical interim-agreements, where the parties promise to add in future the missing elements of integration so that these agreements should correspond to GATT/WTO law. Once political and developmental considerations are at issue, it is evident that the global assessment of RTAs becomes extremely complex and this is even more so when there is not even an unanimous view of the economic consequences of regional integration. At the same time it is also clear that the WTO cannot behave like the GATT contracting parties for which the lack of consensus in the relevant working groups was a welcome excuse not to do anything. The WTO has to act for the following reasons:

- The long feared competition between multilateralism and regionalism becomes more and more a reality. As shown above, regionalism is no longer a mainly European phenomenon but poses a challenge to multilateralism on a global level.
- With the attractive force of the dominant integration areas (the so-called "domino effect" mentioned above) and RTAs creating a network of "second grade" integration areas RTAs are developing a steering and coordination potential which is on a par if not superior to that of multilateral institutions such as the WTO.
- In the ambit of a framework which relies heavily on diplomatic processes for decision making, dispute settlement and rule compliance such as that of GATT, indulgence towards attempts to circumvent article XXIV may be justified by broader policy considerations and by the expression of a pragmatic compromise. In an institution like the WTO for which an important element of distinction from the GATT lies in a far-reaching judicialization of its law and which derives an important part of its legitimacy from the specific task to ensure rule-adherence a "blind spot" in an important area like that regulated in article XXIV cannot be tolerated without the WTO risking its credibility.

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tegration Agreements", *Intereconomics* September/October 1997, 225 et seq. (229).

59 Ibid.

With the 1994 Understanding on the Interpretation of article XXIV confirming the general applicability of the GATT dispute settlement provision to issues relating to RTAs, the door was opened for a judicial clarification of the most pressing issues in this field.

Though the WTO with the institution of the CRTA in 1996[60] took care not to neglect the "diplomatic" approach in the sense that a forum was created where regionalism could find consideration with all its multi-varied causes and justifications, it seems that the judicial approach has cast, at least for the moment, a much brighter light on this issue, notwithstanding the fact that this has happened essentially in one single procedure.

In 1999 a GATT panel and afterwards the Appellate Body had the occasion to express themselves about central aspects of regionalism within the WTO system. As these statements were ground-breaking they merit closer examination.

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60 The CRTA was instituted by the WTO General Council (WT/L/127). Its terms of reference are the following:
"(a) to carry out the examination of agreements in accordance with the procedures and terms of reference adopted by the Council for Trade in Goods, the Council for Trade in Services or the Committee on Trade and Development, as the case may be, and thereafter present its report to the relevant body for appropriate action;
(b) to consider how the required reporting on the operation of such agreements should be carried out and make appropriate recommendations to the relevant body;
(c) to develop, as appropriate, procedures to facilitate and improve the examination process;
(d) to consider the systemic implications of such agreements and regional initiatives for the multilateral trading system and the relationship between them, and make appropriate recommendations to the General Council; and
(e) to carry out any additional functions assigned to it by the General Council."

V. The Turkey – Restrictions on Imports of Textile and Clothing Products Case[61]

In the long-lasting process between Turkey and the EC — the relevant Free Trade Agreement dates back to the year 1963 — on 6 March 1995, the Turkey-EC Association Council adopted Decision 1/95 which should introduce 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 the following Turkey introduced, as of January 1996, quantitative restrictions on imports from India on 19 categories of textiles and clothing products. Turkey considered this as a measure directed to apply "substantially the same commercial policy" as the EC on trade in textiles and clothing; a measure, therefore, covered by article XXIV GATT. For India this was a quantitative restriction according to article XI GATT, a measure not even article XXIV allowed to resort to. In the end, India's viewpoint prevailed but the whole controversy permitted a discussion of many details of the legal boundaries of regional integration within WTO law.

The first question to be settled was of a jurisdictional, preliminary nature in the sense that the specific relationship between the functions of the CRTA and the Dispute Settlement Body had to be clarified. There seemed to be a case of overlapping jurisdictions with far-reaching consequences as both bodies not only rely on a totally different deci-

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61 Report of the Panel and the Appellate Body, see note 50. This case has already been widely commented. See, *inter alia*, J. Mathis, "WTO, Turkey-Restrictions on Imports of Textile and Clothing Products", *Legal Issues of Economic Integration* 27 (2000), 103 et seq.; G. Marceau/ C. Reiman, "When and How Is a Regional Trade Agreement Compatible with the WTO?", *Legal Issues of Economic Integration* 28 (2001), 297 et seq.; A. von Bogdandy/ T. Makatsch, "Collision, Co-existence or Co-operation?, Prospects for the Relationship between WTO Law and European Union Law", in: G. de Búrca/ J. Scott (ed.), *The EU and the WTO-Legal and Constitutional Issues*, 2001, 131 et seq.; M. Cremona, "Neutrality or Discrimination? The WTO, the EU and External Trade", in: de Búrca/ Scott, see above, 151 et seq.;. Mavroidis, see note 43.

sion-making process but also the material elements on which they base their decisions differ considerably: The CRTA considers a vast range of elements of economic, legal and political nature, the Dispute Settlement Body decides on legal grounds. For Turkey the right place for an evaluation of this agreement was the CRTA, giving preference to the political elements. The Panel, however, pointed rightly at para. 12 of the Understanding on the Interpretation of article XXIV, mentioned above, according to which the GATT dispute settlement provision should apply "to any matters" of regional integration. How then to solve this conflict?

The panel took an equivocal approach. "Specific measures adopted on the occasion of the formation of a customs union or in the ambit of a customs union" would fall "clearly" under the jurisdiction of the WTO dispute settlement organs while the assessment of the overall compatibility of a RTA with article XXIV would be up to the CRTA as this organ was appositely created and the only one in the position to confront this "very complex undertaking" which involves not only legal but also economic and political elements and which has at its centre not a bilateral conflict between WTO members but questions which are of importance for the system as a whole.[62]

While the position taken by the panel on this question seems very sensible and humble the Appellate Body was not so convinced it should exercise judicial self-restraint. On the contrary, the Appellate Body acting like a constitutional court defending its ultimate, all-encompassing jurisdiction within a given system, was eager to take a different stance and to affirm its unrestricted jurisdiction even on the question of the overall compatibility of RTAs with GATT/WTO law. This clarification seemed to be of such an importance to the Appellate Body that it was made *obiter*, i.e. even without being asked by the parties.[63] Whether this decision was wise remains debatable.[64] The overall

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62 For the panel it was "arguable" that panels do not have jurisdiction for an assessment on the overall compatibility of Customs Unions with the requirements of article XXIV. Panel Report WT/DS34/R of 31 May 1999, para. 9.53, see note 50.

63 This statement was not only made *obiter* but also indirectly, i.e. by reference to a former report:
"[...]The Panel maintained that "it is arguable" that panels do not have jurisdiction to assess the overall compatibility of a customs union with the requirements of article XXIV. We are not called upon in this appeal to address this issue, but we note in this respect our ruling in *India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products*

compatibility of a RTA with GATT/WTO law is, also in view of the many uncertainties left open, a question that requires the taking into consideration of a vast panoply of elements be they juridical, economic or political in nature. To balance these elements and the related interests the dispute settlement organs would need information they do not possess and assume the role of an umpire that they are not equipped for. A case of this kind still has to be brought before the Dispute Settlement Body. As there are many RTAs whose overall compatibility with article XXIV could be questioned, the restrain showed so far by WTO members could be seen as expression of the awareness of the dangers associated with such a move. On the other hand, should this issue once come to the fore, the ensuing challenge to the very heart of the constitutional consensus within the WTO could perhaps prompt the WTO members finally to give more efficacy to the diplomatic assessment mechanism for which the CRTA has been created.

An overall assessment carried out by the CRTA would not necessarily infringe upon the Dispute Settlement Bodies' competence. It would rather allow for a more appropriate attribution of control powers. In extreme cases, even an overall assessment of the compatibility of a RTA to WTO law would be possible under the condition that this assessment would be carried out under a juridical perspective. Normally, of course, the legal assessment of RTAs should be confined to single juridical problems.

If such a "separation of powers" in a two-stage assessment process could be achieved, where the first, diplomatic stage would be necessary, and the second, judicial one, only possible, even conflicting assessments would be apparent rather than real. In fact, if the CRTA comes to the conclusion that minor legal imperfections of a proposed RTA should not stand in the way of an otherwise politically and economically commendable integration project the DSB may adopt a report which contains a finding on a violation of WTO law if a WTO member is prepared to complain. The future will show whether the WTO dispute settlement organs are capable by their own to act with self-restraint in a manner as proposed here or whether this has to be imposed by a legislative act.

Perhaps the most important question addressed by the Panel and the Appellate Body concerned the potential scope of an article XXIV ex-

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on the jurisdiction of panels to review the justification of balance-of-payments restrictions under article XVIII:B of the GATT 1994[...]".

64 Critical in this regard von Bogdandy/ Makatsch, see note 61, 138.

ception. In other words: to what extent could the creation of a RTA exempt WTO members from WTO obligations? The Panel referred the article XXIV exemption directly and exclusively to the Most Favoured Nations obligation according to article I, while the Appellate Body accepted a broader scope of this exception. In this context, the Appellate Body attributed particular relevance to the chapeau of para. 5 of article XXIV. Its relevant part reads as follows:

> "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)".

The Appellate Body interpreted "shall not prevent" as "*shall not make impossible*" and inferred from that that also provisions other than article I could be derogated should the formation of a Customs Union become otherwise impossible.[65] The Appellate Body stated in its report the following: "[...] 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".[66] The Appellate Body, however, also made it clear that not every derogation from provisions other than article I could be justified under article XXIV. Any derogation must, instead, come up to the following conditions, referred to the specific situation of a Customs Union:

- First of all, the relevant measure has to be introduced upon the formation of the Customs Union.[67]

This condition is primarily directed at guaranteeing transparency and legal certainty. Furthermore, it appears to encourage a strict interpretation of the article XXIV exception, since those measures not introduced upon formation of the RTA do not seem to be absolutely necessary for its existence.

- Second, the Customs Union has to fully meet the requirements of subparas 8 lit. a and 5 lit. a of article XXIV.

This means that the respective WTO members have to prove that the Customs Union respects the "substantially-all-the-trade"-criterion described above, that substantially the same duties and other regulations of commerce are applied by each of the members of the Customs Union to the trade of territories not included in the union and that the

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65 Appellate Body Report, para. 45.

66 Ibid.

67 Ibid., para. 52.

duties and other regulations of commerce imposed at the institution of the Customs Union are not, on the whole, higher or more restrictive than the general incidence of the duties and regulations of commerce that were applicable before.

These are essentially the criteria by which the drafters of article XXIV tried to translate the central economic condition of para. 4, according to which the trade creating effects of integration should prevail over the trade diverting ones, into a legal norm in relation to which compliance should be controllable. We have, however, seen that the vagueness of these provisions leaves many questions open and to attribute the task to fill these lacunae to a judicial organ means that this organ is bestowed with enormous power. The Panel took a very pragmatic approach. It did not specifically address the question of whether the RTA between Turkey and the European Communities really meets the requirements of the paras 8 lit. a and 5 lit. a, limiting itself to assume that this compatibility was in fact given. As this assumption was not appealed the Appellate Body could not address it. Nonetheless, the Appellate Body took the occasion to warn the panel that it had to require the parties to prove that the conditions required had been fulfilled.[68] It will be interesting to see in which way the panels will, in future, respond to this invitation.

- Of decisive importance for this case was, finally, the third condition, referring to the "necessity" of the measures introduced. The parties to a RTA should prove the "necessity" of the derogations in question and bring evidence that otherwise it would be impossible to create the respective formation.

In literature it has been maintained that by stating this the Appellate Body had introduced a rule which inverted the previous practice: it was no longer the other parties who had to demonstrate the inconsistency of a planned RTA with article XXIV but it was up to the members of this agreement to prove the necessity of the derogations in the sense described before.[69] Turkey asserted that had it not introduced quantitative restrictions, the European Communities would have excluded these products from free trade within the Turkey/EC Customs Union in order to prevent trade diversion. In view of the enormous relevance trade in textiles and clothing has in this Customs Union (40 per cent) such an exclusion would have made it impossible to respect the substantially-all-the-trade criterion. The Appellate Body maintained, however, that

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68 Ibid., para. 59.

69 See, for example, Marceau/ Reiman, see note 55, 312.

the introduction of quantitative restrictions on textiles and clothing products from India was not necessary for the creation of a Customs Union between the EC and Turkey.[70] Like the Panel, the Appellate Body pointed at the fact that Turkey could, for example, "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 unions, *and* those textile and clothing products originating in third countries, including India."[71]

In the end, however, the Appellate Body left the door open for another finding in another situation: "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* be justified by article XXIV. We find only that the quantitative restrictions at issue in the appeal in this case were not so justified."[72]

What lessons can be drawn from this decision? The Appellate Body has accepted that the regional exception according to article XXIV can have potentially a very large scope as this exception is not confined to the MFN principle. At the same time the Appellate Body showed, however, clear boundaries to this exception. Derogations of this kind should be accepted only if their necessity was demonstrated. In this sense the creation of such formations remains a right, but a conditional one. Indirectly, the Appellate Body has highlighted that it did not support the position sustained in the past by some authors that article XXIV as a "structural exception" put RTAs in the same place as the multilateral system.[73] The primary function of such formations is, on the contrary, still to be seen in their contribution to the strenghtening of the multilateral system. This report may, on a whole, also be seen as a hint that the WTO dispute settlement organs will, from now on, look

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70 Appellate Body Report, para. 61.

71 Ibid., para. 62.

72 Ibid., para. 65.

73 It was said that both multilateralism and regionalism were conducive to the same end, to the liberalisation of trade, the only difference between them lying in the fact that regionalism pursues this end in an indirect way. See, for example, R. Imhoof, *Le GÀTT et les zones de libre échange*, 1979, 35; F. Jaeger, *GATT, EWG und EFTA: Die Vereinbarkeit von EWG- und EFTA-Recht mit dem GATT-Statut*, 1970, 159. Now, the subsidiary role of regionalism has clearly been highlighted.

very closely at the interplay of regional and multilateral forces within the world trade order and not accept that the former prevail.

All in all, the Appellate Body saw in RTAs more an exception to multilateralism rather than an equivalent alternative to it for which WTO members could freely opt. This exception should not be interpreted as strictly as possible guaranteeing at the same time that the creation of RTAs should be rendered impossible. In literature it has been argued that in so reasoning the Appellate Body not only defined the scope of article XXIV with regard to its coverage but also the nature of a Customs Union.[74] It has been inferred that the Appellate Body had used as a reference model the EC before the completion of the common commercial policy when internal controls and barriers still existed.[75] Does this mean that so-defined Customs Unions form the outer border of RTAs which can still be subsumed under article XXIV? Are, therefore, higher forms of integration, such as Common Markets, inadmissible?

Such a conclusion would, of course, be unacceptable. The necessity-criterion has rather to be applied on a case-by-case-basis. For a RTA uniting two geographically distant countries in a Customs Union which shows no significant political cohesion, the elimination of all internal borders may not be strictly necessary to achieve the bulk of the economic goals the respective integration agreement was directed at. In a Common Market the elimination of all internal barriers may, from the outside, give the impression that a fortress is being build but this more extended digression from multilateralism may be justified in view of the broader political goals pursued by this agreement. It is, therefore, misleading to believe that WTO law is, in principle inimical to deeper integrated RTAs. In this field, as in many others, WTO law has rather to balance interest: that of non-participating countries which are interested in trade relations being as little distorted as possible, against that of the RTA members which want to rely on the particular regime of article XXIV for a multitude of reasons amongst which political considerations rank very prominently. It is therefore not one single reference model on which a specific integration attempt has to be gauged, but the allowed "deepness" of a RTA varies in dependence from the necessities of the specific case to be assessed from the subjective perspective of the countries willing to integrate. It is clear that in those cases in which the

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74 See M. Cremona, "Neutrality or Discrimination? The WTO, the EU and External Trade", in: de Búrca/ Scott, see note 61, 151 et seq. (182).

75 Ibid.

proposed RTA pursues mainly economic goals the necessity-criterion will be the subject of an assessment which will be far more objective in nature than in the case of a regional integration project with predominant political connotations.

The Appellate Body report in Turkey-Restrictions on Imports of Textile and Clothing Products case should therefore not be interpreted as the expression of a new WTO philosophy which wants to reduce regionalism to a mere marginal role or even to pose outright obstacles to regionalism. Though it is true that regionalism and multilateralism do not hold the same value and reputation in WTO law the specific role attributed to regionalism is not a marginal one and it commands the necessary respect. The most important conclusion we can draw from this case it that article XXIV may not serve as an excuse for abuses. The necessity-criterion is, therefore, not an instrument to reduce the role of regionalism in WTO law but to make sure that RTAs really pursue the aims this exception to multilateralism has been created for. As there are not only a multitude of reasons for which the regional exception has been created and as the most important, the political one, can be of most varied forms, so the RTAs and article XXIV must offer sufficient leeway for this necessary variety.

VI. The European Union and Modern Trends in Regional Integration

As has been shown above Western Europe has always been at the centre of the regional integration movement: first to maintain colonial preferences, then as the beneficiary of special consideration in the ambit of EC integration and finally, when article XXIV seemed to have lost all its force of restraint, as a self-conscious actor on the international stage which seemed to be determined to carve out its preferential structures in international trade relations.

As a consequence, at the present day, the greatest concentration of RTAs can be found in Europe, with the EC and the EFTA at the centre, both entities being tied to a whole network of RTAs over further agreements.

These agreements cover not only the Western part of the European continent but also its Eastern and South-Eastern regions.

Paradoxical as it may seem at the first glance, the extraordinary success of these integration movements will also lead to a reduction of the

number of RTAs in force in Europe. In fact, the enlargement of the EC by 12 accession candidates (Bulgaria, Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, the Slovak Republic and Slovenia) will render obsolete the relative bilateral association agreement (10 of which are so-called Europe agreements) by the year 2007. The newly acceding countries, will, on the other hand, become integration partners not only with each other and the 12 traditional EC countries but also with all the other countries which are part of the large integration network stretching well beyond Europe.[76]

The EC has not only been *per se* a successful integration zone but it has also been very successful in creating a large network of RTAs, thereby creating a focal centre where a Customs Union connects with a large number of Free Trade Areas. Two main problems arise in this context.

First, there is the problem of overlapping RTAs, a phenomenon of world-wide importance but of special relevance for the European continent characterized in the meantime by criss-crossing, mainly bilateral RTAs where the EC stands at the centre and other countries are connected to this centre through RTAs like spokes in a hub (so-called "hub-and-spoke"-system). This development engenders a flurry of problems.[77]

The most important one is to be seen in the fact that the overlapping of RTAs with different scope, coverage, depth of liberalization and rules of origin (where FTAs are concerned) creates a widely intransparent situation and enormous administrative costs.[78] What are intended to be preferences in bilateral perspectives may be acts of outright discrimination when seen from a more distanced, multilateral point of view. Where RTAs overlap a situation is created in which regional integration may produce effects which directly counterbalance those resulting from the application of the MFN principle. In this situation, regionalism is no longer a valid alternative to multilateralism and conducive to the

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76 See regional Trade Integration under Transformation, para. 13, see note 4.

77 These problems have recently been described in detail by A. Sapir, "Trade Regionalism in Europe: Towards an Integrated Approach", *Journal of Common Market Studies* 38 (2000), 151 et seq. (158 et seq.) and in the report Regional Trade Integration under Transformation, para. 10 et seq., see note 4, prepared by the WTO Secretariat.

78 See WTO Secretariat, Rules of Origin in Regional Trade Agreements, WT/REG/W/45. As it is known, this problem has been described by *Bhagwati* as the "spaghetti bowl of regional integration".

same end but, instead, clearly threatening the multilateral framework. This problem is evident where different rules of origin collide. It stands to reason that in a heavily integrated world, rules of origin are of decisive importance to maintain independent FTAs. The more demanding they are the greater are the trade diverting effects ("trade deflection") also partly hindering trade with goods coming from outside the FTA but further processed within. Rules of origin can become one of the most important protectionist instruments and the object of costly lobbying activities.

In such a situation of dubious access of products originating from the "spokes" in the "hub-market" it is a small wonder that investors prefer to invest in the "hub-market" instead of the "spoke-market".[79]

As the straight solution to the rules of origin-problem, the transformation of all FTAs in Customs Unions is, in most cases politically not feasible, a "second-best"-approach could be seen in a world-wide harmonization of the rules of origin. Attempts in this sense are, especially on the regional level,[80] under way but different national preferences, and, not least, the will to preserve a protectionist instrument stand in the way of a rapid success of such endeavours.

Furthermore, the different coverage of overlapping RTAs and the different phasing out of preferences enhance, especially in the field of agricultural products, the need for control measures, thereby adding again to the administrative costs.

In view of this array of problems generated by overlapping FTAs which are not only hypothetical but very real many compelling questions arise: why are FTAs still allowed? Why do members of regional integration initiatives not resort to Customs Unions in which trade deflection is not possible?[81] Does article XXIV still offer valid criteria for

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79 Cfr. Sapir, see note 77, 159, referring to R.E. Baldwin, *Towards an Integrated Europe*, 1994.

80 In Europe, the PANEURO system of rules of origin has to be mentioned. On the basis of this system a single set of rules of origin and of diagonal cumulation of origin is applied to preferential trade between the EC, the EFTA states and the Central and East European countries. As these countries have, again, preferential trade relations with other countries on a world-wide level and as they are taking recourse, also in these relations, to the PANEURO system this system is gaining importance far beyond the European region. Cf. WTO Secretariat Report, see note 4, 10 et seq.

81 This, of course, is only true if this Customs Union fulfils substantially-all-the-trade-criterion and if it is fully implemented.

the evaluation of RTAs? In fact, today regionalism presents a picture, especially in Europe, which could hardly have been foreseen half a century ago. It could therefore be argued that the regional exception according to article XXIV is based on an economic theory which no longer corresponds adequately to the challenges of reality. Most important of all, it could be argued that the inefficiencies caused by overlapping RTAs must be known to the members of such agreements. Why, then, do these countries allow the advantages of regionalism to be offset by these dysfunctional developments?

The answers to all these questions lie mainly in a fact, that this article has already been pointed at:

Regionalism is not only an economic phenomenon but also, in some cases mainly, a political one. Often, the creation of a Free Trade Area is an expedient when the political consensus for a Customs Union is not given. Criss-crossing, overlapping RTAs reflect the complexities of international relations where personal sympathies between statesmen, historic ties between nations and membership in broader alliances often count more than economic reason. Therefore, preferential economic relations that may seem awkward from a purely economic viewpoint may appear to fit well in a sensible scheme when seen in a more holistic perspective.

Secondly, the EC has been one of the most important actors in the attempt to use regional integration as a development instrument. Again, what was thought to be an important step forward in the attempt to foster cooperation between North and South resulted, in the end, in widespread discrimination between single developing countries and questionable results even in the preferred countries. The EC in its development policy followed and, in many cases, heavily influenced the rather tortuous way along which the special role of developing countries in GATT/WTO law was subject to continuous change. As is known, the development issue caused a considerable amount of headache in GATT/WTO circles (or, respectively, among the Member States) and the response to this problem was a never-ending trial-and-error process where the definite answer is not yet in sight. Looking back half a century it could be said that this process has gone almost full circle. While GATT 1947 was originally widely ignorant of the woes and needs of developing countries, the only exception having been arti-

cle XVIII,[82] with the introduction of Part IV in 1965,[83] developing countries were allowed to depart from the reciprocity obligation in RTAs – both in those concluded among themselves as in those concluded with industrialized countries. While this exception was thought to be of a temporary nature not unlike a waiver with the introduction of the so-called Enabling Clause[84] a permanent basis for a privileged treatment of developing countries in a multilateral setting where otherwise the principle of non-discrimination was paramount was created.[85] In hindsight, it is doubtful whether this was the right way for promoting the interests of the developing countries as RTas among those countries proved to be largely unsuccessful[86] and the preferential agreements between developed and developing countries were highly trade-distortive. Also from a legal point of view these special relationships were hardly defensible, a fact that became more and more evident as the relevant law was clarified over the years.

The special, non-reciprocal preferences between industrialized countries and developing countries have always been a contentious issue. They cannot be justified on the basis of article XXIV as their non-reciprocal character stands in the way of the "substantially all the trade" criterion. The EC has tried to justify them on the basis of Part IV of the GATT and with reference to the so-called enabling clause. Part IV of the GATT was added to this agreement in 1965 with the special purpose of allowing the concession of preferences to developing countries in a non-reciprocal way. The enabling clause was a decision of the CONTRACTING PARTIES of 1979 whereby the possibilities of pref-

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82 This provision allows for special measures of governmental assistance (especially import restrictions) in the case of Contracting Parties which are in the early stages of development.

83 The relevant provisions entered into force on 27 June 1966.

84 Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries of 28 November 1979 (GATT L/4903), GATT BISD 26S 1980, 203-205.

85 On the whole issue see recently E. de Vos, "The Cotonou Agreement: A Case of Forced Regional Integration?", in: G. Kreijen (ed.), *State, Sovereignty, and International Governance*, 2002, 497 et seq.

86 Nonetheless, they make up for a considerable percentage of the whole number of RTAs: the WTO Secretariat, para. 26, see note 4, estimates that of 243 RTAs in force at the time the respective draft was written, between 30-40 per cent were agreements between developing countries. Until now the appeal of such agreements with developing countries seems to be unbroken.

erential treatment should be still enlarged. This approach was, however, not totally convincing as these provisions did allow for the concession of special preferences to the developing countries but not for the discrimination between these countries.

The whole problem gained most of its publicity with regard to the so-called *Lomé* Agreements.[87] While the WTO compatibility of the *Lomé* IV agreement could be ensured only by a waiver[88] in the successor regime, the *Cotonou* agreement, a waiver is no longer pursued, at least for the time after this new regime becomes fully operative in 2008.[89] The EC had to take note of the fact that the time for this kind of preference was over and that a waiver suited to cover this exception on the long run was probably no longer obtainable.[90] Most impressively, in various stages of the long banana dispute before the GATT/WTO dispute settlement organs it became clear that the old preferential policy

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87 As it is known, since 1976 four Lomé Agreements, distinguished by Roman numerals, have been concluded.

88 In a working party set up to examine the compatibility of Lomé IV with the GATT provisions several members voiced strong objections pointing at the fact that Part IV of the GATT allowed only for special treatment of developing countries on a generalized basis and not for single countries or groups of countries. See GATT BISD 41S 1994, 125 (128). Though upholding their traditional position the European Community applied subsequently for a waiver which was granted by a decision of the Contracting Parties of 9 December 1994 until 29 February 2000, the date of expiry of Lomé IV. See J. Huber, "The Past, Present and Future ACP-EC Trade Regime and the WTO", *EJIL* 11 (2000), 427 et seq. (430).
As is known, the waiver granted for the Fourth Lomé Convention was not the only one directed to assure GATT/WTO compatibility of RTAs. Other waivers for RTAs still in force regard the US-Caribbean Basin Economic Recovery Act (CBERA) concluded between the United States and 21 Caribbean and Central countries as well as the CARIBCAN, concluded between Canada and 18 Caribbean countries. See WTO Secretariat, Report, see note 4, 9 note 25.

89 In fact, the aim is to conclude either fully fledged RTAs on the basis of article XXIV or to grant preferential status on the basis of the Enabling clause to those ACP countries which qualify as LDCs.

90 For the transitory period until 2008, when the Cotonou regime will become fully WTO compatible, however, a waiver may still be necessary. It has to be noted that any such measure will no longer be governed by the rather "liberal" (or, to put it differently, vague) provision in article XXV GATT but by the much more demanding provisions in the para. 3 and 4 of article IX of the WTO agreement.

for former colonies of single EC countries could no longer be upheld.[91] This jurisprudence can be seen as the expression of a new attitude towards preferences for developing countries taken by the WTO as a whole. In this context it is planned to withdraw the special preferences granted to the bulk of the developing countries and to fully integrate them in the multilateral regime on the basis of equal rights and duties.

Only for those developing countries which pertain to the group of the least-developed-countries will the special and differential treatment continue to apply, though this special regime shall be phased out step by step as soon as the countries concerned "graduate" to a more developed status. These being the preconditions for preferential cooperation set by the multilateral framework the EC had to undertake a thorough restructuring of her large network of agreements in this field and the *Cotonou* agreement was surely the most significant step in this direction.[92]

The question whether these agreements were compatible with the general, multilateral framework, has been present since the day of their conclusion and it was, as already mentioned, mainly the degree of awareness of this problem that has continuously risen. In this sense, it can be said that the EC has always been prepared to challenge the multilateral rules in this field believing that the risk was contained and that it would, in any case, always control the game. For years, this assumption may have corresponded to reality but in the meantime it no longer holds true. While the EC is still the dominant player in international regionalism, things have changed since the heyday of European regionalism in the 1960s and 1970s. The United States, in particular, have now discovered the attractiveness of regionalism, first by a Free Trade Area with Canada, afterwards through the creation of NAFTA. The next

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91 For a detailed account of this jurisprudence see P. Hilpold, *Die EU im GATT/WTO-System*, 1999.

92 The same is true for the "second-generation" Euro-Mediterranean agreements concluded between the EC and the countries of North Africa. These agreements should intensify the cooperation between the EC bloc and several countries of the Northern African region not only on an economic level but also on a political one. In this latter regard issues such as the fight against illegal immigration and the attempt to promote the idea of democracy has gained paramount importance. At the same time these new agreements offered an ideal opportunity to enter into an economic cooperation regime on the basis of the principle of reciprocity thereby also countering any criticism about the WTO compatibility of these agreements. For the year 2010 a "Euro-Mediterranean" free trade area is planned.

goals seem to be the Free Trade Area of the Americas (FTAA) and the Trans-Atlantic Free Trade Area (TAFTA).

VII. Conclusion

Regional integration has become a world-wide phenomenon. As has been shown, the integration tendencies have even been accelerating in the last years. Also among developing countries regional integration has become popular through *inter-se* agreements. Though it must be said, that the attempt to copy the European success has all but failed.[93]

In view of this situation, the EC has discovered the virtues of rule-adherence. Generally, the EC tries to renegotiate its non-reciprocal agreements so that they can be based on article XXIV. A particular problem is represented by the association agreements concluded in view of the accession of the 12 candidates mentioned above. They contain large exemptions with regard to the agricultural area. The "substantially all the trade" criterion most likely prohibits the exclusion of a whole area from the integration obligation and in particular one of such an importance as agriculture. On the other hand, these agreements are of a provisional nature and shall lead to full membership. Therefore other WTO members might probably abstain from action.

On the whole, two main elements have to be taken into consideration with regard to the situation described above. First of all, the considerations made for regional integration in general also apply to the special issue of regional integration between developing countries: no solution can be found if this matter is considered only from an economic point of view. Developing countries resort to regional integration initiatives both for economic as for political reasons. The finding that a specific initiative is economically unsound is therefore not sufficient to convince the participating countries to abstain from it. On the other hand, political reasons are difficult to judge by third parties interested mainly in a functioning multilateral framework. This means that it may be difficult for third parties — in our case for the EC — to second-guess the political decision by third parties to conclude a RTA. From

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93 See World Bank, *Trade Blocs, A World Bank Policy Research Report*, 2000. For an attempt to distil lessons from the European integration process and to apply them on the developing countries context see L.A. Winters, "What Can European Experience Teach Developing Countries About Integration?", *World Economy* 20 (1997), 889 et seq.

this follows the second important conclusion. In view of the pivotal importance of the principle of reciprocity the best approach to choose by the EC might be to take seriously its traditional leadership in the field of regional integration and to draw all the necessary consequences. It can be said, therefore, that there are good reasons for the EC to try to mend the system as its many defects are apparent and defeats before WTO dispute settlement organs are looming. But the most important reason for this newly found confidence of the EC in multilateral trade rules is the fear of imitations.[94]

In this, the behaviour of the EC can best be explained by theories developed by the social sciences such as the prisoner dilemma and the theory of the second-best, both already mentioned in this article. With regard to the first theory it is important to note that the EC has learnt to take into consideration the possibility of reactions by other states and the fact that cheating does not pay off on the long run. Although in this field the times of reaction are relatively long and in the first years after GATT had come into existence it seemed that Europe was the natural — and by far the most important — playing ground for regional integration experiments, after several decades even the staunchest advocate of multilateralism, the United States, has adapted to this new situation and shows that it is very able of playing this game. As a consequence, the EC is now demanding a more detailed regulation of the rules of the game.

With regard to the second theory it was said that "it was precisely in the context of preferential trading arrangements that the Byzantine complexities of the second best were first discovered."[95] As is known, the theory of the second best has met with harsh criticism in literature.[96] The recommendation that the failure to attain the optimum in one area of a general equilibrium should be taken into consideration when other optima pursued in the sense that the Pareto optima have not to be determined in an isolated way but under consideration of all changes to the applicable conditions deriving from the first-mentioned area appears to be theoretically compelling but in many cases impossible to translate into practice for the lack of the necessary information.[97] In practice it may still be preferable to pursue first-best-solutions even

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94 See, in particular, European Commission, WTO relevant aspects of EU preferential agreements with third countries, SEK (96) 2168 final.

95 See Krugman, see note 8, 58. See also Pomfret, see note 36, 460.

96 Cf., for example, D. Brümmerhoff, *Finanzwissenschaft*, 2001, 117 et seq.

97 Ibid.

knowing that the results are not Pareto optima when the available information is insufficient for the necessary adaptations.

Applied to the RTA issue this criticism strongly recommends to hold on to multilateralism. This criticism finds expression — though not expressly and most probably not knowingly — in the reports of the panel and the Appellate Body in the Turkey-Restrictions on Imports of Textile and Clothing Products case where it was confirmed — as already stated — that regionalism is no equivalent alternative to multilateralism. It follows implicitly from the adoption of the necessity principle — as defined above — that every effort has to be made to avoid restrictions that go beyond a mere exception of article I GATT. As a consequence, it can be said that the modern interpretation given to the theory of the second best needs to be very careful towards all too sweeping demands for exceptions to the general multilateral framework.

With regard to the EC it has to be noted that this institution is itself interested in stable multilateral trade relations and in open markets on the basis of the MFN principle. It has now much to fear that other countries are in the meantime copying the EC's unruly behaviour of the past.