FTA and the WTO Regime – Explaining the Spaghetti Bowl Effect

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Introduction

Regionalism amongst the countries of the world is a very common concept. No country in today's world can live in isolation. In earlier times, most of the regional agreements were military alliances where the countries which are signatories to the agreement, promised to support each other in case of an invasion by a third country.

Post-industrialization, the countries realized that they need bigger markets to ensure production is conducted at the maximum capacity and also ensure profit on the same. Post-industrialization, various countries realized they needed bigger markets to conduct production at maximum capacity, leading to more profits. This led to the rise of economic regionalism where the countries entered into agreements with each other to ensure market access and to develop certain common institutions to regulate the inter-country trade. These inter-country trade agreements were preferred by countries that were close to each other geographically. This led to them being referred to as regional trade agreements. However, over a period, as the means of transportation and communication developed, the trade agreements stopped being regional and started spreading out to the global level, wherein,

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agreements were entered into between various countries having no geographical commonalities.

Such trade agreements exist even today and are bifurcated into various categories depending upon their peculiar characteristics. In the current system of multilateralism, the existence of the Most Favoured Nation (MFN) obligation renders such agreements an exception. However, due to their immense proliferation, they have become more of a regular norm. This paper intends to discuss the issue of the existence of the FTAs under the WTO regime, more specifically, as per Article XXIV of the GATT.

Preferential Trading Agreements

Preferential Trading Agreements (PTA) are a broad category of trading agreements wherein signatories to the agreement are given preferential treatment with respect to trade in certain goods or services or both. This preference can be in the form of reduced tariffs or reduced qualitative and quantitative restrictions.

The world has, in the recent years, seen a considerable growth in PTAs entered between various countries. This growth is essentially due to three major reasons: first, unlike multilateral trade agreements, PTAs are entered into by a select group of countries having common interest making it easier to negotiate the terms of trade.[1] Secondly, the countries that enter into PTAs have complete control over state policy and they exercise complete autonomy during negotiations.[2] Thirdly, the negotiations that take place during the formation of a PTA are completely based on the principle of reciprocity and,

1 Amin Alavi, Preferential Trade Agreements and the Law and Politics of GATT Article XXIV 1 BEIJING LAW REVIEW 7 (2010).
2 *Id.*

unlike multilateral trade negotiations, no country enjoys any concession by the virtue of being a free rider.

Economic integration amongst the countries of the world is very important for the global economy to flourish. Economic integration essentially means various countries coming together and adopting a common trade policy to reduce or eliminate the trade barriers.[3] Formation of PTAs induces such an economic integration, as the reason behind entering into a PTA is to make reciprocal promises to improve trade relations between countries by reducing the barriers. On the outset, such an agreement seems to be perfectly valid and, in some cases, even necessary. However, it goes against the principle of MFN, which is a sine-qua-non of international trade. This is the reason why all kinds of PTAs are not legal under the WTO regime and the WTO members are permitted to enter into only those types of PTAs, which are explicitly allowed under the provisions of GATT, 1994. The WTO permits the formation of PTAs, in the form of FTAs and Customs Unions, under Article XXIV of the GATT, 1994. This was majorly because such PTAs would encourage the members to come together and negotiate terms of trade, which they might not be able to do at the multilateral level considering the enormity and rigidity of the process. Article XXIV (4) explicitly mentions that "the purpose of a customs union or an FTA should be to facilitate trade between the constituent territories." The importance of Article XXIV was also reiterated by the panel in the case of Turkey – Restrictions on import of textile and clothing products.[4]

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[3] Abc Of Preferential Trade Agreements: Frequently Asked Questions, Monographs On Globalization And India, Myths And Realities (Cuts Centre For International Trade 2009).

[4] Panel Report, Turkey – Restrictions On Imports Of Textile And Clothing Products, WTO Doc. WT/DS34/R (May 31 1999)

However, while acknowledging the probable positive effects of PTAs, the potential harms that it can cause should not be ignored. According to its traditional usage, a PTA means an agreement by which one country opens its boundaries and its market to another country for a range of goods or services or both but does not lead to a general liberalization of all trade.[5] This means that by way of such a PTA agreement, the parties may agree to any terms amongst themselves irrespective of its effect on the other countries, which are not a party to the PTA. Thus, a PTA will in no circumstance further the trade liberalization goals envisaged by the multilateral trading system unless it is subjected to the conditions included in the GATT 1994. These conditions included that the purpose of a PTA must be to facilitate trade and that the barriers to trade and commerce between the constituent territories must be eliminated over a period of time.[6] Additionally, to create a valid PTA under GATT, 1994, the member countries cannot raise or make stricter the duties and other trade regulations that they had in place when the PTA was formed.[7]

History of the Multilateral Trading System with respect to PTAs

The trend of various countries entering into trade agreements is nothing new as many countries have tried to enhance and strengthen their trade relations with other countries since time immemorial. Similarly, the debate about which form of trade agreement is better than the other, is also not a new one as it has always been the trend for countries to enter into bilateral and plurilateral agreements.

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5 Peter Hilpold, Regional Integration According to Article XXIV GATT - Between Law and Politics 7 MAX PLANCK YEARBOOK OF UNITED NATIONS LAW ONLINE 219 (2003).

6 General Agreement on Trade and Tariffs, 1994, at Article XXIV, ¶ 8.

7 General Agreement on Trade and Tariffs, 1994, at Article XXIV, ¶ 5.

It is not wrong to state that, most of the time, any trade agreement has always led to the expansion and liberalization of trade. However, it is also true that this development has not taken place consistently. There have been times when the trading blocs led to a lot of conflict between countries and imposed an immense strain on the available resources.

This trend began in colonial empires such as the Roman and Ottoman eras and can be seen even in modern colonial empires such as the British. .[8] During such times, the countries were not really entering into agreements to explore new markets and to increase their economic capabilities but to simply avert a common practice of arrest of foreign merchants that used to take place in various countries.[9] By virtue of these agreements, the countries could secure a promise from each other that their merchants will not be arrested in other countries and will be given a treatment equivalent to that of domestic merchants.[10] During the nineteenth century, this strict bilateral and plurilateral trade agreements began paving way to more openness and lesser trade restrictions. This trend was kick started by Britain itself even though it was the country that had most colonial preferences. As a result of this attitude many countries started entering into reciprocal agreements with each other and the tariffs were cut to almost half of what existed earlier. Despite the countries' inclination towards liberalization, due to the economic depression of 1873 – 1877, the pressure on the countries to become self-sufficient in production of essential goods and war materials became very important.[11] Since colonialism had also reached new heights, most of the countries such

8 World Trade Organization (ed), The WTO and Preferential Trade Agreements: From Co-Existence to Coherence (WTO 2011).

9 *Id.*

10 *Id.*

11 *Id*.

as the USA and Britain started entering into agreements with their colonies itself for supply of raw materials on preferential terms. Due to this shift towards an extremely preferential trading system, various trade wars broke between different countries and this led to the near extinction of the willingness of the countries to form universal trade rules and to establish an institution for the observance of the same.[12]

Inclusion of Article XXIV in the GATT, 1947

After the first and the second world war, there was a consensus that the inequalities among the countries in economic development and in access to new markets were crucial causes which lead to tension between the countries.[13] It was necessary to bring back the world economic order as it was, and the only way to do so was to encourage trade liberalization. USA whole-heartedly backed the Most Favoured Nation Principle at the multilateral level. [14] Ironically, it was the USA that had passed the Smoot – Hawley Tariff Act, a few years back, which was completely against free and fair trade. This essentially meant that, USA was against all trade based on a preferential system.

However, this new arrangement was not welcomed equally by all countries as they already had their preferential arrangements in place, and they did not want to let go of the preferential arrangement to something uncertain like the MFN obligation. For instance, Britain was fully in favour of keeping its

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12 For example, the Franco-Italian conflict (1886-95); the Franco-Swiss conflict (1892-95); the Russian-German conflict (1893-94); the Spanish-German conflict (1894-99); the Romania-Austro-Hungarian conflict (1886-93).

13 Jagdish N Bhagwati, Termites in the Trading System: How Preferential Agreements Undermine Free Trade (Oxford Univ Press 2008).

14 *Supra note 8.*

imperial preferences in place and thus rejected the MFN principle.[15] As a result of this opposition from Britain and other countries, the GATT was adopted on 30th October 1947 and it included certain preferential arrangements already existing, as exceptions to the MFN under Article I.[16] Further, when the negotiations for setting the terms of trade under GATT, 1947 had started, the USA realized that the arrangement in the form of a Customs Union (CU) was something that was essential to ensure European integration. With the cold war taking place between the USA and Russia, the former found it imperative to advance European economic integration so that the balance of power in the world remains in favour of the USA.[17] The United States' support for customs unions led to the inclusion of customs unions and interim agreements to form a customs union, an exception to the MFN principle. However, free trade agreements were not included as an exception to the MFN principle at this stage.

Soon after the GATT, 1947 was adopted, the countries started the negotiations to establish an institutional framework for regulating international trade in the form of ITO (International Trade Organization). The negotiations for the same were conducted in the United Nations Conference on Trade and Employment at Havana from November 1947 to March 1948.[18] After this conference, the GATT parties had their first meeting in which they came up with the concept of an FTA. The formal proposal for the inclusion of FTAs as an exception to the MFN principle, akin to CUs, was introduced by Lebanon and Syria and it was backed by France and most of the developing

15 'The Legal Dimension: GATT Article XXIV and the WTO jurisprudence on RTAs' (2004) The Dimensions of Regional Trade Integration in Southeast Asia, pp. 35–79. doi:10.1163/9789004479685_007.

16 General Agreement on Trade and Tariffs, 1994, at Article XXIV, ¶ 2

17 *BHAGWATI, supra note 13.*

18 *HAFEZ, supra note 15.*

countries who found this to be an efficient method of establishing their regional blocs and improving their negotiating power at the multilateral level.[19]

Interestingly, the USA also backed the proposal for inclusion of FTAs as an exception to the MFN principle. One of the reasons behind the USA's change of stance is assumed to be that the US policy makers actually believed that discriminatory trade liberalization is also a valid step towards trade liberalization, and hence, encouraged the formation of an FTA as it will further the goals of the multilateral trading system.[20] According to one economist, USA was desperate to reach an agreement with respect to setting the terms of international trade on the basis of reciprocity and thus to avoid any resistance to the agreement. USA felt pressured, by Britain and certain other countries, to include the excessive exceptions to the MFN principles.[21] Another explanation for the change in the American stance was that, since Britain was completely against the idea of application of the MFN principle, there was a possibility that they would completely abandon multilateralism and instead preferred to embrace its colonies.[22] Such a situation would have led to the formation of a humongous trading bloc and it would have led to probable closure of the markets of the colonies to the rest of the world, thereby causing a huge problem in the USA's potential trading plans.[23] Therefore, the

19 *Id.*

20 *BHAGWATI, supra note 13.*

21 Jacob Viner, The Customs Union Issue, New York: (Carnegie Endowment for International Peace 1950)

22 John Odell and Barry Eichengreen, 'The United States, the ITO, and the WTO: Exit Options, Agent Slack, and Presidential Leadership', in Anne O. Krueger (ed.), The WTO as an International Organization (University of Chicago Press 1998)

23 *Id.*

USA found it easier to allow preferential trading along with its rules and regulations in place.

Proliferation of FTAs and the Spaghetti Bowl Effect

In addition to understanding the history that led to the change, from concentration on multilateralism to inclusion of FTAs in the GATT, 1947, it is also important to understand the trend of the proliferation of the FTAs that took place since the adoption of GATT, 1947. The proliferation of the FTAs took place in a compartmentalized manner, more specifically, in three waves. The first wave of proliferation was not so much in the form of FTAs as it was in the form of CUs. It started in the late 1950s and continued till the 1960s. The European countries inaugurated this wave in 1957 by forming the European Economic Community, which was essentially a form of continental integration of Europe. However, not all the European Countries were a part of this integration, which ultimately led to a rival FTA being formed known as the European Free Trade Agreement (EFTA) in 1957. Keeping these two formats of integration as an example, many other regions such as Africa, Caribbean, Central and South America, etc. also entered into similar agreements. These latter agreements fizzled out eventually and ultimately collapsed in the 1970s. Apart from these major agreements, no other countries were hit by this first wave of regionalism and no further CUs or FTAs were formed. However, a thing to be noted is that the European integration was followed by an increase in the multilateral negotiations as well, as the Dillon round of negotiations and the Kennedy round of negotiations took place successfully. Therefore, the trend evidences multilateral integration and the European integrations taking place side by side during this time.

The second wave of regional integration took place between the 1980s and the 1990s. It started with the European Community (EC) converting into a

common market where all the physical, technical and tax barriers were eliminated amongst its members. EC also started entering into bilateral agreements with the Central and the East European countries. Furthermore, in the 1990s, many bilateral agreements were entered into between the EC and the middle eastern countries such as Israel, Jordan, Lebanon, Palestine and some North African Countries. Until this point of time, the secret FTA between the USA and Canada had not materialized, and USA had continued to be in favour of multilateralism. However, being intimidated by the European expansion with respect to FTAs and being frustrated with the delay in the initiation of the Uruguay round of negotiations, USA also started entering into FTAs. It entered into an FTA with Israel in 1987 and then in 1990, it formed the NAFTA with USA, Canada and Mexico as its members. In these FTAs various trade related areas such as investment, services and intellectual property rights were also negotiated upon, something which was not yet done at the multilateral level.

Soon, the developing countries also started entering into similar arrangements. One of the major arrangements in this aspect was the MERCOSUR, a CU formed between Argentina, Brazil, Paraguay and Uruguay. It was a first of its kind PTA that included only developing countries. Soon, the African countries also joined forces with the Common Market for Eastern and Southern Africa (COMESA), East African Community (EAC), Economic Community of West African States (ECOWAS) and Southern African Development Countries (SADC). This second wave had hit Asia as well with the Association of Southeast Asian Nations (ASEAN), ASEAN Free Trade Area (AFTA) and South Asian Free Trade Agreement (SAFTA). This wave was very widespread as almost all the regions of the world were undergoing economic integration. It was a surprise

that in spite of this intense wave of regionalism, the Uruguay round of negotiations was a success and led to the formation of the WTO.

A third wave of regionalism started soon after the establishment of the WTO. The EU and the USA once again initiated this wave. The Asian countries that, till this point of time, were keeping regionalism to the minimum and supporting multilateralism also started their regional integration. These Asian bilateral talks majorly took place between Japan, the Republic of Korea, Singapore, China and India. Furthermore, USA has also entered into FTAs with Jordan, Bahrain, Singapore, etc. It must be noted that during this latest wave of regionalism, a variety of arrangements such as bilateral, plurilateral and cross regional FTAs were being entered into. This wave is also witnessing many FTAs between developed – developed countries, developing – developing countries and developed – developing countries.

Motivation behind joining a FTA

Having discussed in depth about the history behind the inclusion of FTAs in the GATT regime and the trend of proliferation of the FTAs in recent times, it is imperative to understand the motivation of the countries to form an FTA. Many countries truly believed that entering into an FTA had more trade-creating effects and thus, led to liberalization. Therefore, the supporters of the FTAs piggy-backed on the support of a multilateral trading system and stated that both of these arrangements ultimately lead to the same end, that is, liberalization of trade.[24]

The proliferation of treaties took place in a deferred manner. Europe was the region, which was actively entering into various FTAs and improving its economy by adopting the preferential system of trading. Most of the countries

24 *BHAGWATI, supra note 13.*

have entered into FTAs due to this influence of Europe, and, by blindly following Europe's steps, every country hoped to expand and prosper like Europe.[25]

In addition to this, there was an immense bureaucratic influence with regards to the formation of FTAs. It was observed that entering into multilateral negotiations and considerably reducing the tariffs in a reciprocal manner did not get as much attention and appreciation as entering into an FTA did. Consequently, most of the bureaucrats, in a quest for recognition, entered into many FTAs without heeding to its effects on the world trading system.[26]

After initial trade negotiations, tariffs in most sectors were significantly reduced. However, negotiations later stalled, especially on tariffs. Developing countries sought greater market access and tariff reductions, but realized that free-riding was no longer beneficial. As developing countries, they had little bargaining power to conduct trade negotiations on their own. This led developing countries to believe that forming a free trade agreement (FTA) would give them better recognition at the multilateral level and increase their bargaining power. Additionally, as tariffs were not decreasing, developing countries felt desperate and entered into FTAs to reduce trade barriers and improve market access among themselves.

One of the major motivations behind countries forming FTAs is to insulate themselves against the harms of failures of the multilateral negotiations.[27] This is evidenced by the fact that the USA started entering into FTAs due to the delay in conducting the Uruguay round. When the multilateral negotiations do not take place regularly, the countries' trade policies remain

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25 *Id.*
26 *Id.*
27 *Id.*

the same, and the benefit that they ought to receive by reciprocal negotiations is denied to them. This encourages them to enter other arrangements such as an FTA to ensure continuation of negotiations, and reduction of the trade barriers.

Another reason why a country forms an FTA is to gain credibility and security.[28] This is true when a developing country forms an FTA with a hegemon. To improve investments, it is imperative for the policies of the government to be more reliable. If a hegemon forms an FTA with the developing country, it will obviously reflect that the developing country is in a very good position and has credibility. This leads to an increased flow of investments from various parts of the world.

Lastly, FTAs did not just lead to economic integration between the constituent members of the FTA. It also led to social, cultural, political, and military integration. Thus, parties whose real motive is to develop these other forms of integration may form an FTA.[29]

Article XXIV of the GATT – The catalyst of regionalism in the Multilateral Trading System

Article XXIV is one of the most controversial provisions in the GATT. The discussion regarding this provision has gained momentum in recent times due to the whole debate about whether the proliferation of the FTAs is undermining the multilateral trading system. It is indeed a surprise that the WTO system, which affords so much importance to the multilateral system

[28] *Supra note 8.*
[29] *Id.*

of negotiation and the MFN principle, includes Article XXIV as an exception to these core principles. There are diverse views expressed by various commentators regarding the nature of this provision, some of them being as follows:

> 'Article XXIV is "extremely elastic" (Curzon, 1965: 64), "unusually complex" (Dam, 1970: 275), and "full of holes" (Bhagwati, 1993: 44) due to language that is full of "ambiguities" and "vague phrases" (Haight, 1972: 397). Haight (1972: 398) impugns Article XXIV as an "absurdity" and a "contradiction", while Dam (1970: 275) brands it "a failure, if not a fiasco".'[30]

The technical conditions for forming a customs union (CU) or free trade agreement (FTA) are very strict. However, over time, these conditions have been diluted, which has led to the misuse of the provision. As noted by the famous economist, Mr. Jagdish Bhagwati, it was always thought that the recourse to Article XXIV resorted to by the countries in rare circumstances due to the extreme demand of virtually free trade with respect to nearly all the products.[31] It was believed that such a condition would discourage the countries from forming FTAs under Article XXIV. A playful remark explains the rationale behind Article XXIV that, "it was like prohibiting lovemaking through promiscuity and sanctioning it only if the wedding rings were exchanged, which is a more demanding commitment."[32]

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30 Kerry Chase, Multilateralism Compromised: The Mysterious Origins of GATT Article XXIV 5 WORLD TRADE REVIEW 1 (2006).

31 *BHAGWATI, supra note 13.*

32 *Id.*

However, Article XXIV which otherwise laid down a rigourous procedure for a valid FTA to be formed under its ambit is now blatantly diluted and misused. The reason behind this is that many countries convoluted the provision to support their own gains and no one raised a voice against such convolution at the proper time. The convolution of the provision has majorly taken place with respect to the formation of FTAs. Consequently, at this stage where this web of FTAs has brought under its ambit almost all the countries of the world, it has become difficult to solve the problem of proliferation of FTAs. To understand and find the solution to the problem caused by these FTAs, it is necessary to understand the major provisions of Article XXIV.

There are three provisions, namely, Article XXIV: 4, Article XXIV: 5 and Article XXIV: 8, that deal with the formation of an FTA. These three provisions broadly lay down the conditions that need to be fulfilled by the countries to be notified as an FTA under the auspices of the WTO. Each of these three provisions have certain issues in them with respect to which no solutions have been found and thus are being misinterpreted by the countries to fulfill their personal gains. In addition to these substantive provisions, there are certain provisions, which lay down the procedure that must be followed by the countries forming an FTA as well as the WTO member countries for declaring an arrangement between countries as an FTA.

Purposive Nature of the FTAs

Article XXIV:4 of GATT states that the purpose of a free trade area (FTA) should be to facilitate trade between the constituent countries and not to raise trade barriers against non-FTA countries. In other words, FTAs should be designed to make it easier for goods and services to flow between the member countries, without making it harder for goods and services from non-FTA countries to enter the member countries' markets. This provides the purpose

for which the countries may form an FTA. Paragraph 4 of Article XXIV provides for the general principles related to the formation of an FTA whereas, paragraph 5 – 9 provide for the specific rules. A question arises as to whether the provision under paragraph 4 should be considered as a purpose test that must be satisfied before considering an arrangement to be an FTA under Article XXIV. Considering the language of the Article XXIV: 4, it says the purpose of an FTA 'should be' to facilitate trade, which reflects it to be precatory in nature or as a mere suggestion.[33] However, another view states that paragraph 4 of Article XXIV must be taken to be the chapeau, and, the paragraphs 5 – 9 must be considered as the hard rules, thereby implying that, for an arrangement between countries to qualify as an FTA, it has to fulfill the purpose test laid down in paragraph 4 in addition to the conditions laid down in paragraph 5 – 9.[34] However, this issue is yet to be solved and conflicting opinions and arguments are raised with respect to it. In the 1950s when the EEC Treaty was examined by the working party, this question had come up and EC had demanded 'interpretational independence' between the provisions of paragraph 4 on one hand and the provisions of paragraph 5 – 9 on the other.[35] The EC stated that, firstly, paragraph 4 of the Article XXIV does not lay down a separate test to be fulfilled by the countries to form an FTA and secondly, the fulfillment of the provisions of Article 5 – 9 should essentially lead to a conclusion that the FTA is in compliance with paragraph 4 as well.[36] This issue was also raised before the Appellate Body

33 M. Matsushita, 'Legal Aspects of Free Trade Agreements: In the Context of Article XXIV of the GATT 1994', in M. Matsushita and D. Ahn, eds., WTO and East Asia: New Perspectives (London, Cameron May 2004) p. 497 at p. 504.

34 *HAFEZ, supra note 15.*

35 *Id.*

36 *MATSUSHITA, supra note 33.*

of the WTO Dispute Settlement Mechanism in the *Turkey Textiles* case and the Appellate Body held the following opinion:

"Paragraph 4 contains purposive, not operative, language. It does not set forth a separate obligation itself but, rather, sets forth the overriding and pervasive purpose for Article XXIV, which is manifested in operative language in the specific obligations that are found elsewhere in Article XXIV. The provisions of Article XXIV are to be interpreted in the light of the purpose set forth in Article XXIV:4 through a process of 'constant reference to this purpose'."[37]

Meaning of 'substantially all trade' under Para 8 of Article XXIV

One of the most controversial questions about Article XXIV is the interpretation of the term "substantially all trade" in paragraph 8. Paragraph 8(b) of Article XXIV of the GATT defines a free trade area (FTA) as an agreement between two or more countries to eliminate duties and other restrictive regulations of commerce on substantially all trade between them. Understanding the interpretation of this term 'substantially all trade' is central to interpreting the rigidity of Article XXIV.

As previously stated, when the provisions of FTA were negotiated and included in the GATT, 1947, none of the parties thought that it would lead to the proliferation of FTAs due to the strict requirement of undertaking trade without any barriers amongst the constituent countries. This requirement was evidenced by paragraph 8 (b) as it said that FTAs must liberalize substantially all trade amongst themselves. However, over the years, this term has been given a very wide interpretation causing many arrangements with partial liberalization to fall under the category of FTAs. The contracting parties of

[37] Appellate Body Report, Turkey – Restrictions on Imports of Textile and Clothing Products, WT/DS34/AB/R, adopted 19 November 1999, ¶ 57, 58.

the GATT have acknowledged this problem and the need to clarify it, however, as of now, no clarification regarding the meaning of 'substantially all trade' has been decided upon. In the *Turkey Textiles* case[38], the Appellate Body addressed this issue as they stated, "substantially all does not mean all trade and means more than some trade."[39] When the proliferation of the FTAs started taking place, it was found out that the FTA countries were sometimes leaving out entire sectors from being liberalized and this prima facie leads to a situation of partial liberalization, which is not allowed under Article XXIV.

To decide this issue, the extent of trade that needs to be liberalized to fulfill the conditions of paragraph 8 (b) needs to be determined. To determine the extent of trade that should be liberalized, two elements may be considered, namely, qualitative and quantitative. Qualitative element includes the actual volume of trade that flows amongst the FTA members and the quantitative element includes the number of tariff lines on the products that are traded amongst the FTA members.[40] Various countries have given their input as to what should be the factor to be considered to conclude that the FTA has eliminated duties and other restrictive regulations of commerce on substantially all trade. During the examination of the Treaty of Rome in 1997, this issue had cropped up and EC had mentioned that if trade barriers with respect to more than 80% of the trade between the FTA members are eliminated, it may be construed to fulfil the condition of paragraph 8 (b). This stance of Europe is in favour of determining liberalization of substantially all trade on the from the point of view of quantitative aspect, that is, the actual volume of trade taking place amongst the FTA members. However, the other

38 *Id*

39 *Id.*

40 *MATSUSHITA, supra note 33.*

countries rejected this stance stating that instead of a hard and fast rule, a better way of determining 'substantially all trade' would be to decide on a case – by – case basis. During the Economic Partnership Agreement (EPA) negotiations taking place between EU and African, Caribbean, and Pacific (ACP) countries EU showcased their inclination in considering substantially all trade to mean 90% of the trade that flows between the constituent members. By this, EU necessarily implied that the remaining 10% of the trade, which is not liberalized, might include an entire sector of products or services in which the trade is taking place. This suggestion of EU was also supported by the EFTA countries as they believed that entire sectors may be left out of the liberalization process within an FTA since paragraph 8 (b) stated 'substantially all trade' and not 'trade in substantially all products.[41] The USA was not in favour of this and proposed that substantially all trade should mean that all sectors must be included and limits relating to trade liberalization may be set based on various sectors.[42] This opinion of America was more leaning towards using the qualitative aspect for determining liberalization in substantially all trade, that is, deciding the tariff lines on products, which are traded. Australia suggested that substantially all trade should mean 95% of the trade that flows amongst the FTA countries at the level of Harmonious system (HS) 6 units must be eliminated.[43]

At the international level, a consensus regarding the correct interpretation of 'substantially all trade' was not reached. However, there are some instances where the WTO DSB and the Contracting Parties have expressed their

41 *HAFEZ, supra note 15.*

42 *ALAVI, supra note 1.*

43 Md Rizwanul Islam And Shawkat Alam, Preferential Trade Agreements And The Scope Of GATT Article Xxiv, GATS Article V And The Enabling Clause: An Appraisal Of GATT/WTO Jurisprudence 56 Netherlands International Law Review 1 (2009).

unanimous view about this. In *Turkey Textile* case[44], it was noted by the Appellate Body that substantially all trade includes both the qualitative and quantitative components.[45] This issue was also considered by the working party while examining the EFTA as it stated that the term substantially all trade refers to not only the quantitative aspect but also the qualitative aspect.[46] Even during the examination of the *EC – Finland* FTA, the working party explicitly stated that liberalization in substantially all trade means liberalization in all products and will not allow exclusion of a whole sector.[47] Considering these views, it may be concluded that simply defining a minimum percentage of trade that should be liberalized will not fulfill the condition set down in paragraph 8 (b). This conclusion can also be reached by the careful perusal of the interpretation of Article XXIV which states that closer economic integration will increase trade and that if more trade restriction is removed, it will lead to better economic integration. It also states that if many trade restrictions are not removed and major sectors are excluded from the ambit of liberalization, it will lead to reduction of economic integration. This could lead us to the conclusion that since the purpose of an FTA is to increase world trade by encouraging economic integration and since exclusion of major sectors from the liberalization plan of the FTAs will lead to lesser integration, such exclusion will not be GATT compliant.[48] However, if this is concluded, the question that will arise is what is a major sector?

Procedural requirements under Article XXIV

44 *Supra note* 38

45 *Turkey – Textile, supra note 38, ¶ 49*

46 *MATSUSHITA, supra note 33.*

47 *Id.*

48 *Id*

The provisions of GATT require multiple compliances to be followed by the countries with respect to informing the other members about their trade policies to ensure transparency of policy and rules throughout the world. The same approach of the GATT exists with respect to the contracting parties entering into FTAs as well. Various procedural compliances must be undertaken by the countries entering into FTAs to ensure transparency regarding the countries' trade policies and to ensure that the resultant FTA fully complies with the conditions imposed by Article XXIV. Any WTO member that decides to enter into an FTA or an interim agreement for the formation of an FTA must immediately notify the other WTO members and provide them with enough information so that they can examine and make recommendations on the proposed FTA.[49] The GATT 1947 does not have a specific format for FTA notifications, but it does require that they be done in a way that is fair and reasonable. Once an FTA member notifies the GATT of a proposed FTA, a group of experts is formed to review the FTA and make recommendations to the GATT Council, if necessary.[50] However, the WTO Committee on Regional Trade Agreements (CRTA) now examines FTAs. Proposed FTA members notify the WTO of their intent to form an FTA. The WTO then forwards the notification and information to the CRTA, which investigates whether the FTA complies with the GATT.

When two or more countries notify the WTO of an interim agreement for the formation of an FTA, they must also include a plan and schedule for completing the negotiations and implementing the agreement within a reasonable period of time.[51] The term "reasonable period of time" is not

[49] General Agreement on Trade and Tariffs, 1994, at Article XXIV, ¶ 7 (a).

[50] J. Huber, The Practice of GATT in Examining Regional Arrangements under Article XXIV, 19 JOURNAL OF COMMON MARKET STUDIES p. 281 (1981).

[51] General Agreement on Trade and Tariffs, 1994, at Article XXIV, ¶ 5 (c)

defined in the GATT, and this has led to some countries misinterpreting it. For example, the Greece-EEC association submitted a plan and schedule for the formation of an FTA after 22 years, which is widely considered to be an unreasonable period of time.[52] At the 2001 Doha Conference, WTO members agreed to develop rules of procedure for FTAs. In 2006, they adopted the Transparency Mechanism, which clarified the broad and loosely drafted terms of Article XXIV of the GATT. It laid down a time period within which the FTA should be notified to the WTO members. Now, it must be notified immediately after the ratification and before the terms of trade negotiated under the FTA are implemented.[53] Once the WTO members receive the notification, the examination process must start immediately and must proceed according to a well-defined timetable and the examination must be completed within 1 year from the date of notification.[54] Further, to enable the WTO members to conduct an assessment of the notified FTA, the secretariat is asked to make a report on the factual aspect of the PTA.[55] The proposed FTA members are also required to immediately notify the WTO members in case of any change in the plan or situation which affects the implementation of the terms of trade undertaken by the FTA.[56] In order to ensure that the purpose of the transparency mechanism is definitely achieved, a responsibility is also cast on the other members of the WTO to notify about any arrangement in the form of an FTA that they come across at any point of time.

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52 *HAFEZ, supra note 15.*

53 WTO, Transparency Mechanism for Regional Trade Agreements*,* Decision of 14 December 2006, WTO Doc. WT/L/671 (18 December 2006) (Decision on Transparency Mechanism).

54 *Id*, ¶ 3

55 *Id*, ¶ 7 (b)

56 *Id*, ¶ 10

Despite these exhaustive procedural requirements imposed on the countries intending to form an FTA, history witnesses that these procedures are hardly followed. The entire reason why Article XXIV is being misused in the recent times is because of the lax attitude of the WTO members in not following the procedure. The FTA or CU, which is notified, needs to be examined to ensure that it complies with Article XXIV. However, it can be observed that at the time of examination of the EEC treaty, the requirements of Article XXIV were not at all fulfilled. However, the GATT contracting parties could not stop the implementation of the EEC treaty because of the threat of withdrawing its membership given by EC.[57] After this debacle, sixty-nine working parties were formed for the examination of different FTAs out of which only in six cases a consensus was reached with respect to the compliance of the FTA with Article XXIV. However, none of the working party reached a consensus that a particular FTA is not in compliance with Article XXIV when in fact data reveals that many of the FTAs undertake partial liberalization, which is strictly restricted in case of an FTA under the WTO regime. The imperfect and loose drafting of Article XXIV also adds fuel to the fire since every country can argue upon the meaning of the provision.

Conclusion

Regionalism is here to stay. It has existed since the time trade came into being and it will continue until the countries of the world decide to give up their boundaries and become a part of a single global village. This fact was highlighted especially in the negotiations that took place at the multilateral level and finally, a provision had to be carved out, which allowed such

57 *MATSUSHITA, supra note 33.*

preferential trading agreements to exist as an exception to the MFN obligation. Although many countries opposed the inclusion of such a provision, today, almost every country of the world has become a party to such an arrangement. This proliferation of the FTAs, which has taken place in recent times, is, in fact, proving to be a threat to the multilateral trading system. The practice of the countries to enter into multiple FTAs remains unchecked and this is majorly due to the ambiguity of Article XXIV of the GATT, 1994, which is the provision which allows the FTAs to exist in the first place.

In addition to the ambiguity of the afore-mentioned provision, the fact that there is absolutely no limit with regards to contents of the FTA has led to a situation wherein multiple systemic issues have arisen between the functioning of the FTA on one hand and that of the WTO on the other, which have been discussed in the further chapters. The ambiguity of Article XXIV of the GATT, 1994 and the systemic issues and conflicts that exist between the FTAs and the WTO can be resolved only if the countries acknowledge that such a problem exists and take collective measures to solve these problems.