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Regional Trade Arrangements, Generalized System of Preferences and Dispute Settlement in the WTO

Avadhoot Nadkarni

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Planning Commission Chair and Unit in Planning and Development
Department of Economics
(Autonomous)
University of Mumbai
Mumbai – 400 098

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Avadhoot Nadkarni[2]

Abstract

Though several cases involving Article XX, which provide general exceptions to the MFN Clause in Article I, have been brought to the WTO Dispute Settlement Mechanism, the cases invoking Article XXIV and the 'Enabling Clause' have been very few. This Article and the 'Enabling Clause' also provide exceptions to the MFN Clause. The paper discusses two cases with India as a complainant – one involving Article XXIV and the other invoking the 'Enabling Clause'. The Dispute Settlement at the WTO has unambiguously laid down that the operation of the Regional Trading Arrangements in general and the Generalized System of Preferences in particular does not call for unnecessary restrictions on the exports of non-partners or unnecessary discrimination among developing countries in the operation of the GSP schemes of the developed countries.

Keywords: Regional Trading Arrangements; GSP; WTO

JEL Codes: F13, F15

1 Introduction

Regional Trade Arrangements (RTAs) are clearly an exception to the Most Favoured Nation Clause of the General Agreement on Tariffs and Trade. Three Articles of GATT provide exceptions from applying its provisions, viz., Article XX providing the general exceptions for, *inter alia*, protecting plant, animal and human life, Article XXI providing exceptions for reasons of national security, and Article XXIV permitting members of a regional arrangements like free trade areas or a custom unions not to extend to other member countries the concessions that they extend to each other as members of such arrangements. The most-favoured nation clause, of course, requires that a member country must immediately and unconditionally grant to all other members any concession that it grants to a fellow member or to some fellow members. Since forming a regional

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[2] Professor of Planning and Development

trade arrangement requires that some members are given concessions that are not extended to others, it follows that RTAs would not have been GATT consistent if not for the explicit exception provided by Article XXIV. Such an exception is also provided by the 'Enabling Clause'.

The term 'Enabling Clause' refers to the agreement on 'Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries' in the International Trading System. It allows developed WTO member countries, in the interest of development, to grant concessions to developing members without according the same treatment to other members, just as Article XXIV allows such discriminatory treatment in the context of RTAs. The measures used under the Enabling Clause include, *inter alia*, the Generalised System of Preferences (GSP) and treatment for the least developed countries. Countries like the United States and the European Union have granted concessions, outside the purview of RTAs, through schemes formulated by them like the GSP. Other examples of such schemes include the African Growth and Opportunity Act and the Andean Trade Preference and Drug Eradication Programme.

Applications of GATT exceptions have been keenly contested. Several cases have been brought to the Dispute Settlement Mechanism of the WTO and earlier to the relevant GATT bodies which have invoked Article XX general exceptions to rationalise trade restrictions imposed by member countries. There are, however, only a few cases that invoke Article XXIV. There are also some which invoke the 'Enabling Clause'.

In what follows we examine two WTO Dispute Settlement Cases, one having to do with an RTA and the other with a GSP. In both cases India has been a complainant. The RTA case was brought against Turkey, whereas the GSP Case was brought against European Union (EU). The outcome was in favour of India in both the cases.

The remaining part of the paper is organised as follows. Section 2 deals with the RTA case brought by India to the WTO Dispute Settlement (DS) against Turkey. Section 3 deals with the GSP case brought against the EU. Section 4 brings out some implications

of current Doha Round Negotiations for the RTA dispute settlement in particular. Section 5 offers some concluding comments.

2 Restrictions on Imports of Textiles and Clothing Products by Turkey Pursuant to the Turkey-EU Customs Union

As brought out above, this is one of the few cases under the WTO DS which involves the custom union issue. We look at some aspects of the case before bringing out some conclusions in Section 5.

2.1 The Parties and the Product Involved and the Measure at Issue

The case was brought by India against Turkey regarding Turkey's quantitative import restrictions on textiles and clothing from India pursuant to the formation of Turkey-EU customs union. Earlier, Turkey was involved in a similar case with Hong Kong and India had requested to be joined in consultation between Hong Kong and Turkey. Hong Kong, China, Japan, the Philippines Thailand, and the US reserved their third-party rights in this case.

2.2 The Time Line

India requested consultations with Turkey on the matter on March 21, 1996 and, on failure of consultations, requested the establishment of a Panel on February 2, 1998. A Panel was established by the Dispute Settlement Body (DSB) at its meeting on March 13, 1998. The report of the Panel was circulated to the Members on May 31, 1999.

Turkey notified its intention to appeal certain issues of law and legal interpretations developed by the panel. The report of the Appellate Body was circulated on October 21, 1999. The DSB adopted the Appellate Body report and the Panel report as modified by the Appellate Body report at its meeting held on November 19, 1999. The case hence extended for a period of 3 years and 8 months from the request for consultation to the adoption of the reports and for a year and 8 months since the request for the establishment of the panel.

2.3 Issues and Findings

India claimed that Turkey's quantitative import restriction measures were inconsistent with Article XI (General Elimination of Quantitative Restrictions) and Article XIII (Non-Discriminatory Administration of Quantitative Restrictions) of GATT. The Panel found that Turkey's measures were inconsistent with Articles XI and XIII, i.e., the measures implied quantitative restrictions that were not administered in a non-discriminatory manner by Turkey.

The custom union issue arises because Turkey had asserted that that its measures are justified by Article XXIV of GATT. The article provides that members may enter into customs unions or free-trade areas provided they cover substantially all the trade between the partners and that all customs duties and other restrictions on trade between partners of the area/ union are eliminated. Turkey asserted that the quantitative restrictions were necessary to form the customs union with the EU and that therefore its measures were justified under Article XXIV. The panel rejected Turkey's assertion that its measures are justified under Article XXIV. The panel rejected Turkey's assertion because it thought that that there were alternatives available to Turkey that would have met the requirements of Article XXIV: 8 (a), which were necessary to form the customs union, other than the adoption of quantitative restrictions.

As we know, under the dispute settlement procedures of the WTO, the Appellate Body cannot re-examine the facts of the case but can go into the legal interpretations developed by the Panel and examine issues of law. The Appellate Body modified the Panel's legal reasoning underlying its conclusion that Turkey's measures were inconsistent with Article XXIV, though it agreed with this conclusion of the Panel. The Body laid down that in order to determine whether a measure found inconsistent with certain other GATT provisions can be justified under Article XXIV, a panel should examine two conditions. First, whether a 'customs union' as defined in Article XXIV: 8 exists in the sense that all tariff and other restrictions on substantial part of the trade between the presumed partners are eliminated. If a custom union does not exist in this sense, there is no question of justifying the impugned measures under Article XXIV.

Secondly, it has to be ascertained whether the impugned measures, in this case import restrictions, were necessary for the formation of the customs union. The Panel had proceeded to examine the second condition without establishing the first. The Appellate Body also opined, agreeing with the Panel, that the Article XXIV can be invoked as an exception, as was done by Turkey, though the burden of proof under Article XXIV was on the party invoking it.

3 Tariff Preferences Granted by the European Communities to Developing Countries

As we have seen above in the introductory section, this case under the WTO DS involving the European Communities' GSP deals with an issue that is parallel to the customs union issue. We look at some aspects of the case before bringing out some conclusions in Section 5.

3.1 The Parties and the Background to the Issue

The case was brought by India against the European Communities (EC) regarding its scheme of tariff preferences for certain goods from developing countries and economies in transition providing for five different tariff preference arrangements: the general arrangements, the special incentive arrangements for the protection of labour rights, the special incentive arrangements for the protection of environment, the special arrangements for least developed countries, and the special arrangements to combat drug production and trafficking. Of these, the general arrangements of tariff preferences to developing countries up to a margin of preference, as also the arrangements for the least developed countries were thought to be unexceptionable and, as brought out in the introductory section, consistent with the 'Enabling Clause' as defined by the agreement on 'Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries.' The problem is with the other three arrangements, viz., special incentives arrangements for protection of labour rights and environment and the so-called drug arrangements.

A section of the WTO membership has consistently tried to bring in issues related to labour and environmental standards in the WTO and to establish disciplines on these.

It has been thought that the lower level of standards of environmental and labour protection in the developing countries confers an advantage on these countries which translates as an undue competitive advantage in the world trading system. Environmental clauses do exist in the WTO. The general exceptions provided by Article XX of GATT referred to above do explicitly allow trade restrictions for the protection of plant and animal life [Article XX (b)] and also for the conservation of natural resources [Article XX (g)]. Labour standards have always been considered as a matter belonging to the realm of the International Labour Organisation (ILO) and not the WTO. The Singapore Ministerial conference has unambiguously opined against the inclusion of labour standards in the WTO. The special incentive arrangements for the protection of labour rights and environment of the EC should be viewed on this background. India had originally asked for consultation with EC not only on the drug arrangements but also on the special incentive arrangements. The challenge to the special incentive arrangements was however not pursued by India at the stage of requesting a panel as it was thought that the case could be separately pursued especially given the fact that, in practice, the incentive arrangements were applied by the EC only to one country, Moldova, which was a small country with whom India did not substantially compete in the EC market and hence there was not a substantial impairment of advantage.

This was not the case, however, with the drugs arrangement. The benefits of that arrangement applied to 12 countries: Bolivia, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Nicaragua, Pakistan, Panama, Peru and Venezuela. Under these arrangements several products from these countries enjoyed duty-free access to the EC markets. India was particularly competing with Pakistan in the EC market and would suffer a substantial impairment of advantage granted by the MFN clause through the special status granted to Pakistan under the scheme.

India hence initiated DS process against EC in the matter. Many of the beneficiary countries referred to above involved themselves in the case either by joining consultations or by reserving their third-party rights in the case. Other countries that were not beneficiaries of the scheme also reserved their third-party rights including Cuba, Sri Lanka and the US.

3.2 The Time Line

India requested consultations with EC on the matter on March 5, 2002 and, on failure of consultations, requested the establishment of a Panel on December 6, 2002. A Panel was established by the Dispute Settlement Body (DSB) at its meeting on January 27, 2003. The report of the Panel was circulated to the Members on December 1, 2003.

The EC notified its intention to appeal certain issues of law and legal interpretations developed by the panel. The report of the Appellate Body was circulated on April 7, 2004. The DSB adopted the Appellate Body report and the Panel report as modified by the Appellate Body report at its meeting held on April 20, 2004. The case hence extended for a period of about two years from the request for consultation to the adoption of the reports and for a year and 5 months since the request for the establishment of the panel.

3.3 Issues and Findings

India considered that the tariff preferences granted by the EC under its drug arrangements created undue difficulties for her exports to the EC, including under the general arrangements of the EC's GSP scheme. India's contention was that the EC arrangements were inconsistent with Article I: 1 (MFN clause) and also with paragraphs 2 (a), 3 (a) and 3 (c) of the Enabling Clause. Paragraph 2 (a) makes the more favourable treatment applicable to the GSP scheme and a footnote to paragraph 2 (a) requires the GSP scheme to be non-discriminatory between the developing countries. Paragraph 3 (a) requires that the more favourable treatment 'shall be designed to facilitate and promote the trade of developing countries and not to raise barriers to or create difficulties for the trade of any other contracting party, whereas paragraph 3 (c) requires that the more favourable treatment 'be designed and, if necessary, modified, to respond positively to the development, financial and trade needs of developing countries.' Prima facie there was a substantial case in favour of India.

The Panel agreed with India's contention that the drug arrangements under the EC's GSP scheme are inconsistent with the MFN clause (Article I: 1). According to the Panel,

the EC had failed to demonstrate that the drug arrangements were justified under paragraph 2 (a) of the Enabling Clause which, as we have seen above, requires the GSP benefits to be provided on a non-discriminatory basis; and the EC had also failed to demonstrate that the drug arrangements are justified under Article XX (b) of GATT, i.e., the measure is not necessary for the protection of human life or health *in the EC*. The measure is also not consistent with the Chapeau of Article XX which explicitly requires that the measure is not 'applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail…'

On the appeal of the EC, the Appellate Body examined certain issues of law and it upheld the Panel's finding that the Enabling Clause operates as an exception to Article I: 1 of GATT and that the clause does not exclude the applicability of Article I: 1 of GATT. The implications clearly are that there can be no discrimination in the application of the GSP scheme within the group of developing countries. The drug arrangements were not justified under paragraph 2 (a) of the Enabling Clause as, among other things, the measure had not set out any objective criteria, that, if met, would allow for other developing countries that are similarly affected by the drug problem to be included as beneficiaries. The Appellate Body however found that not every difference in the tariff treatment of the GSP beneficiaries necessarily constituted discriminatory treatment. Differences among beneficiaries in terms of 'development, financial or trade need' would enable granting different tariff preferences to products originating in different GSP beneficiaries under the term 'non-discriminatory' in footnote 3 to paragraph 2 of the Enabling Clause.

The Appellate Body had also opined on the 'burden of proof' in the case of disputes involving the Enabling Clause. As a general rule, the burden of proof for an 'exception' falls on the respondent. But, due to the vital role played by the Enabling Clause in the WTO system as a means of stimulating economic growth and development, when a measure taken under the Enabling Clause is challenged, the complainant must identify the specific provisions of the Enabling Clause with which the scheme is allegedly inconsistent and not merely allege inconsistency with Article I: 1. It becomes incumbent, then, on the respondent to defend against the alleged inconsistency with the impugned

paragraph. The Appellate Body found that India had sufficiently alluded to paragraph 2(a) of the Enabling Clause in making its claim of inconsistency with Article I: 1.

4 The Doha Round of Negotiations, RTAs and Dispute Settlement

There has not been sufficient case law developed on the RTAs in the WTO. The WTO membership has, by and large, turned a blind eye to the operation, in practice, of Article XXIV. Many of the existing customs unions and free trade areas are not strictly as defined by Articles XXIV: 8 (a) and XXIV: 8 (b). There are many loose ends even in terms of systemic issues that need to be thrashed out.

As we know, WTO Members agreed at the Doha Ministerial Conference to launch negotiations in the area of 'WTO Rules'. These negotiations relate to the Anti-dumping Agreement (Agreement on Implementation of Article VI of GATT 1994), the Agreement on Subsidies and Countervailing Measures including the WTO disciplines on fisheries subsidies, and WTO provisions applying to Regional Trade Agreements. These negotiations on the 'WTO Rules' are taking place within the Negotiating Group on Rules which reports to the Trade Negotiations Committee. The Group and the Committee have been constituted under the Doha Round of Negotiations that is currently underway.

The relevant issues on RTAs that have to be negotiated have been identified. As in many other WTO groups, the negotiating group on RTAs is also pursuing a two-track approach: identifying issues for negotiation in formal meetings and; holding open-ended informal consultations on more procedural issues related to transparency of RTAs.

The Negotiating Group on Rules has to date negotiated a transparency mechanism on the RTAs which provides for an early announcement of any RTA and its notification to the WTO. Members are to consider the notified RTAs on the basis of a factual presentation by the WTO Secretariat. The review of RTAs will be conducted by the Committee on Regional Trade Agreements or by the Committee on Trade and Development.

The Committee on Regional Trade Agreements will conduct the review of RTAs falling under Article XXIV of General Agreement on Tariffs and Trade (GATT) and Article V of the General Agreement on Trade in Services (GATS). The Committee on Trade and Development will conduct the review of RTAs falling under the Enabling Clause (trade arrangements between developing countries).

This transparency mechanism is being implemented on a provisional basis. Members are to review, and if necessary modify, this decision of the General Council, and replace it by a permanent mechanism adopted as part of the overall results of the Doha Round. Such a permanent mechanism will help minimize the disputes that that would arise in the implementation of RTA Agreements among member countries.

Much work still needs to be done, however, in terms of the systemic issues concerning RTAs. Disciplining many of the issues that arise will help in any future disputes regarding RTAs. Any further agreements among Members, however, have to wait a comprehensive agreement in all the areas under the Doha negotiations.

5 Conclusion

The Dispute Settlement at the WTO has unambiguously laid down that the operation of the RTAs in general and the GSP in particular does not call for unnecessary restrictions on the exports of non-partners or unnecessary discrimination among developing countries in the operation of the GSP schemes of the developed countries. Such discrimination is sought by the developed countries to pursue their objectives like attainment of environmental and labour standards outside their own territorial boundaries. The WTO Dispute Settlement Body has largely not been in favour of such infringements of national sovereignties.

Yet there have been sharp differences in the findings of the Panels and of the Appellate Bodies, the latter examining only issues of law and not the facts of the case, the latter being the responsibility of the Panels. Thus, though the Appellate Bodies upheld the conclusions of the panels in the two cases that we examined, on the matter of law, they reversed some of the findings of the Panels. Thus, in the EC – Tariff Preferences case, the

Appellate had a distinctly different interpretation from the Panel as to meaning of 'non-discrimination' as implicit in the Enabling Clause. It is hoped that the Rules Negotiations in the WTO will help to clarify some of these matters.

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