International and Regional Trade Law: The Law of the World Trade Organization

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Unit II: Globalism v. Regionalism

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Supplementary Reading

For a more complete overview over Regional Trade Agreements and the WTO we suggest the following reading:

Peter van den Bossche, The Law and Policy of the World Trade Organization, 2005, pp.650-667.

Raj Bhala, Modern GATT Law. A Treatise on the General Agreement on Tariffs and Trade, 2005, Chapters 21 and 22, pp. 566-614.

Michael J. Trebilcock & Robert Howse, The Regulation of International Trade, 3rd ed. 2005, pp. 193-201.

John H. Jackson et al., Legal Problems of International Economic Relation, 4th ed. 2002, Chapter 11, 447-478.

1. Introduction

1-1. OVERVIEW

http://www.wto.org/english/thewto_e/whatis_e/tif_e/bey1_e.htm

Regionalism — friends or rivals?

The European Union, the North American Free Trade Agreement, the Association of Southeast Asian Nations, the South Asian Association for Regional Cooperation, the Common Market of the South (MERCOSUR), the Australia-New Zealand Closer Economic Relations Agreement, and so on.

By July 2005, only one WTO member — Mongolia, — was not party to a regional trade agreement. The surge in these agreements has continued unabated since the early 1990s. By July 2005, a total of 330 had been notified to the WTO (and its predecessor, GATT). Of these: 206 were notified after the WTO was created in January 1995; 180 are currently in force; several others are believed to be operational although not yet notified.

One of the most frequently asked questions is whether these regional groups help or hinder the WTO's multilateral trading system. A committee is keeping an eye on developments.

Regional trading arrangements

They seem to be contraditory, but often regional trade agreements can actually support the WTO's multilateral trading system. Regional agreements have allowed groups of countries to negotiate rules and commitments that go beyond what was possible at the time multilaterally. In turn, some of these rules have paved the way for agreement in the WTO. Services, intellectual property, environmental standards, investment and competition policies are all issues that were raised in regional negotiations and later developed into agreements or topics of discussion in the WTO.

The groupings that are important for the WTO are those that abolish or reduce barriers on trade within the group. The WTO agreements recognize that regional arrangements and closer economic integration can benefit countries. It also recognizes that under some circumstances regional trading arrangements could hurt the trade interests of other countries. Normally, setting up a customs union or free trade area would violate the WTO's principle of equal treatment for all trading partners ("most-favoured-nation"). But **GATT's Article 24** allows regional trading arrangements to be set up as a special exception, provided certain strict criteria are met.

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

Article 24 says if a free trade area or customs union is created, duties and other trade barriers should be reduced or removed on substantially all sectors of trade in the group. Non-members should not find trade with the group any more restrictive than before the group was set up.

Similarly, Article 5 of the General Agreement on Trade in Services provides for economic integration agreements in services. Other provisions in the WTO agreements allow developing countries to enter into regional or global agreements that include the reduction or elimination of tariffs and non-tariff barriers on trade among themselves.

On 6 February 1996, the WTO General Council created the **Regional Trade Agreements Committee**. Its purpose is to examine regional groups and to assess whether they are consistent with WTO rules. The committee is also examining how regional arrangements might affect the multilateral trading system, and what the relationship between regional and multilateral arrangements might be.

1-2. LEGAL TEXTS

- Read in the Primary Sources:

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

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

  (…)

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

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

     (…)

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

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

1-3. REGIONAL TRADE AGREEMENTS

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

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

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

1-4. A NEW TRANSPARENCY MECHANISM

WTO: 2006 NEWS ITEMS

10 July 2006
REGIONAL TRADE AGREEMENTS
Lamy welcomes WTO agreement on regional trade agreements

http://www.wto.org/english/news_e/news06_e/rta_july06_e.htm

Director-General Pascal Lamy, on 10 July 2006, welcomed the Negotiating Group on Rules' formal approval of a new WTO transparency mechanism for all regional trade agreements (RTAs).

"This decision will help break the current logjam in the WTO on regional trade agreements. This is an important step towards ensuring that regional trade agreements become building blocks, not stumbling blocks to world trade. It is important to note as well that this breakthrough comes at a critical juncture in our broader Doha round negotiations. Hopefully this decision is a good omen for much needed progress in other areas of the talks, such as agriculture and industrial goods trade, where agreement is urgently needed."

The new transparency mechanism provides for early announcement of any RTA and notification to the WTO.

Members will consider the notified RTAs on the basis of a factual presentation by the WTO Secretariat.

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).

The transparency mechanism is to be implemented on a provisional basis. Members are to review, and if necessary modify, the decision, and replace it by a permanent mechanism adopted as part of the overall results of the Doha Round.

The Chairman of the Negotiating Group on Rules, Ambassador Guillermo Valles Galmés (Uruguay), said the decision is "an early contribution to the Doha Round". He commended the "constructive engagement" of all delegations in the negotiations.

The Negotiating Group on Rules has forwarded the decision to the Trade Negotiations Committee.

RTAs, which includes bilateral free trade agreements between countries that are not in the same

region, have become so widespread that all but one WTO member are now parties to one or more of them.

It is estimated that more than half of world trade is now conducted under RTAs. Some 197 such agreements in force have been notified to the GATT/WTO.

A Committee on RTAs in 1996 replaced separate working parties that have examined these agreements since the GATT.

Differences between members on how to interpret the criteria for assessing the consistency of RTAs with WTO rules have created a lengthening backlog of uncompleted reports in the Committee. In fact, consensus on WTO consistency has been reached in only one case so far: the customs union between the Czech Republic and the Slovak Republic after the break up of Czechoslovakia.

1-5. RULES OF ORIGIN

Technical Information on Rules of Origin

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

Definition

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

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

Where are rules of origin used?

Rules of origin are used:

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

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

— for the purpose of trade statistics;

— for the application of labelling and marking requirements; and

— for government procurement.

No specific provision in GATT

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

"...within the province of each importing country to determine, in accordance with the provisions of its law, for the purpose of applying the most-favoured-nation provisions (and for other GATT purposes), whether goods do in fact originate in a particular country".

Article VIII:1(c) of the General Agreement, dealing with fees and formalities connected with importation and exportation, states that "the contracting parties also recognize the need for minimizing the incidence and complexity of import and export formalities and for decreasing and simplifying import and export documentation requirements" and the Interpretative Note 2 to this

Article states that it would be consistent if, “on the importation of products from the territory of a contracting party into the territory of another contracting party, the production of certificates of origin should only be required to the extent that is strictly indispensable”.

Interest in the harmonization of rules of origin

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

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

Increased number of preferential trading arrangements

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

Increase in the number of origin disputes

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

Increased use of anti-dumping laws

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

The UR Agreement

Introduction

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

Aims of the Agreement

Harmonization

The Agreement on Rules of Origin aims at harmonization of non-preferential rules of origin, and to ensure that such rules do not themselves create unnecessary obstacles to trade. The Agreement sets out a work programme for the harmonization of rules of origin to be undertaken after the

entry into force of the World Trade Organization (WTO), in conjunction with the World Customs Organization (WCO).

General principles

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

Coverage: all non-preferential rules of origin back to top

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

Institutions

WTO Committee on Rules of Origin

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

WCO Technical Committee

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

The Harmonization Work Programme (HWP)

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

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

Definitions of goods being wholly obtained

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

Last substantial transformation

Change of tariff heading

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

Supplementary criteria

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

The CRO considers the input of the TCRO with the aim of endorsing the TCRO's interpretations and opinions, and, if necessary, refining or elaborating on the work of the TCRO and/or developing new approaches. Upon completion of all the work in the TCRO, the CRO is to consider the results in terms of their overall coherence (Article 9:3).

Overall architectural design

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

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

— three Appendices:
Appendix 1: Wholly obtained goods;
Appendix 2: Product rules - substantial transformation; and
Appendix 3: Minimal operations or processes.

Results of the Harmonization Work Programme

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

2. Turkey – Restrictions on Imports of Textile and Clothing Products (Turkish Quantitative Restrictions)

For very long it appeared impossible for a country to challenge a country's justification of GATT violations with Art. XXIV. The following dispute is one of the first ones in which the requirements of the Art. XXIV exception play a role in the dispute settlement. Pay particular attention to the different legal approaches of the panel and the Appellate Body to Art. XXIV and the still contentious question of jurisdiction over GATT Art. XXIV.

When you read panel and AB reports it is important that you analyze and understand the market. With respect to this case ask yourself the following questions: Who asked the Indian government to bring the claim? Why did the European Communities insist on the adoption of quotas on textiles by Turkey?

Which was Turkey's strongest argument and what could Turkey have argued in relation to the AB report?

Summary of Facts

from Case Note by Joel P. Trachtman, (http://www.ejil.org/journal/curdevs/sr6.html)

This case relates to the agreement for the formation of a customs union between Turkey and the EC. In connection with the formation of the customs union, Turkey was required to apply substantially the same commercial policy as the EC in relation to textiles. In 1996, Turkey introduced quantitative restrictions on 19 categories of textile and clothing imports from India. Turkey argued that its action was justified under Article XXIV of GATT 1994. The panel found these quantitative restrictions to be inconsistent with Articles XI and XIII of the GATT 1994 and Article 2.4 of the Agreement on Textiles and Clothing ("ATC").

Editorial Note: The footnote numbering in the panel and AB report as reproduced here does not correspond to the footnote numbering in the original reports.

Report of the Panel, WT/DS34/R, 31 May 1999

Panelists: Armstrong, Wasescha and Human

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

I. INTRODUCTION

1.1 On 21 March 1996, India requested consultations with Turkey pursuant to Article 4.4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU") and Article XXIII:1 of the General Agreement on Tariffs and Trade 1994 ("GATT") regarding the

unilateral imposition of quantitative restrictions ("QRs") by Turkey on imports of a broad range of textile and clothing products from India as from 1 January 1996 (WT/DS34/1).

1.2 India and Turkey did not enter into consultations, due to disagreement on the appropriateness of participation of the European Communities in such consultations, and consequently the dispute could not be resolved at that stage. The Dispute Settlement Body ("DSB") was informed accordingly on 24 April 1996.[2]

(…)

II. FACTUAL ASPECTS

2.1 This section addresses the factual aspects of the dispute in a sequential order, in which the QRs at issue are described in paragraphs 2.39 to 2.41 below. In view of the nature of the dispute, this section outlines first the factual context in which the dispute is addressed.

A. Regional Trade Agreements in the GATT/WTO Framework

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

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

2.4 Before 1957, the GATT contracting parties dealt with only three such agreements, covering a small fraction of their aggregate trade (see Figure II.1), on which compatibility with Article XXIV was temporarily waived and which were maintained under surveillance.[5] Article XXIV provisions confronted their first real applicability test with the notification of the Treaty of Rome in 1957, which concerned the integration of major players in the international scene. From then on, the examination of RTAs notified to the GATT did not lead to clear-cut assessments of full consistency with the rules, except in one instance.[6] Frictions between GATT contracting parties arising in the context of the formation of customs unions or free-trade areas were dealt with pragmatically.[7]

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[2] WT/DSB/M/15, pp. 3-5.

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

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

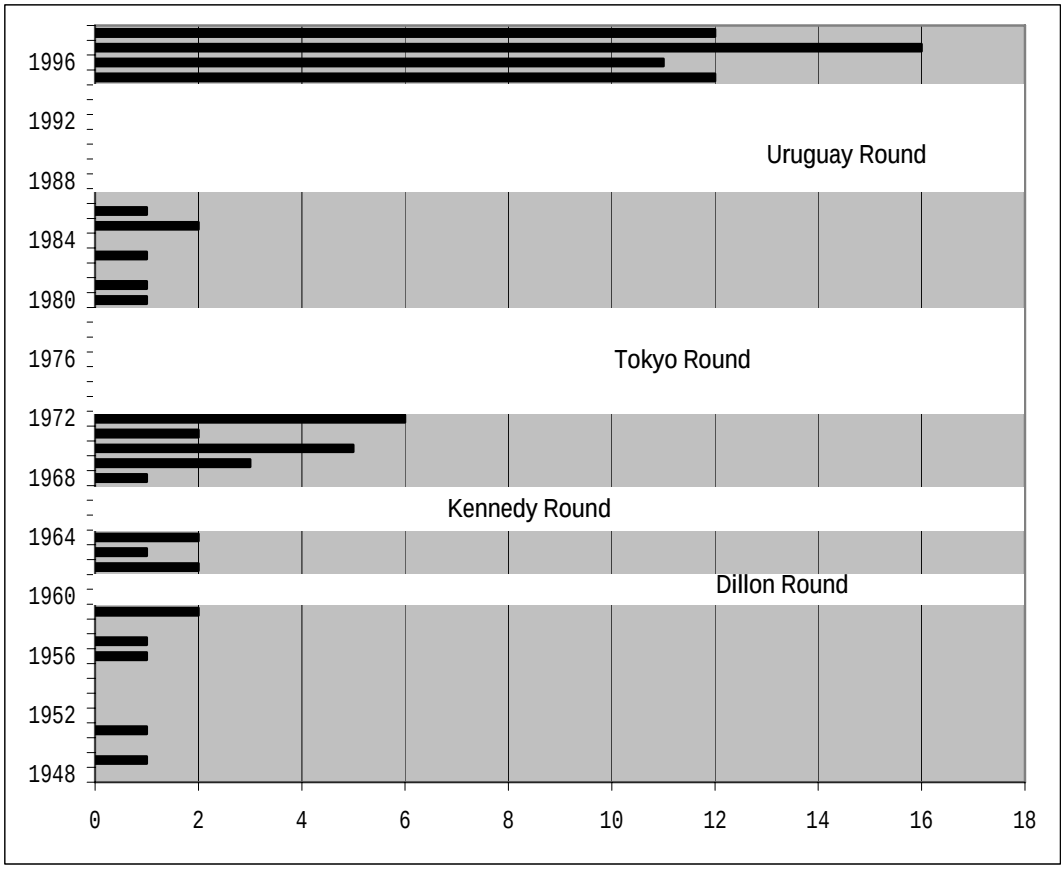
[5] See in this respect: *Report on the Customs Union between South Africa and Southern Rhodesia* (BISD II/176) and corresponding *Decisions* (BISD II/29, and 3S/47); *Decision on the Free-Trade Area Treaty between Nicaragua and El Salvador* (BISD II/30); and *Decision on Participation of Nicaragua in Central American Free-Trade Area* (BISD 5S/29).

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

[7] See, for example, BISD 7S, p. 69 *et seq.*.

2.5 The perception that RTAs could contribute to the expansion of world trade was reiterated during the Uruguay Round, when negotiators re-visited certain aspects of Article XXIV, in an endeavour to clarify some of its provisions.[8]

Figure II.1 – Number of RTAs notified to the GATT/WTO under Article XXIV



2.6 During the course of the Uruguay Round, there was an increase in the number of new RTAs notified to the GATT. The conclusion of the Round and the establishment of the WTO did not put to rest the appeal of regional integration. Since 1 January 1995, a further 60 new RTAs have been notified under Article XXIV of GATT, most of which are presently in force.[9]

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

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

2.7 The WTO General Council established, on 6 February 1996, the Committee on Regional Trade Agreements ("CRTA"),[10] with the mandate of, inter alia, examining all RTAs notified to the Council for Trade in Goods ("CTG") under Article XXIV.[11] The CRTA is likewise entrusted with the examination of those RTAs notified under the 1979 Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries and under Article V of the General Agreement on Trade in Services ("GATS"),[12] and referred to it by the Committee on Trade and Development ("CTD") and the Council for Trade in Services ("CTS"), respectively. The mandate of the CRTA also includes the consideration of "the systemic implications of [RTAs] and regional initiatives for the multilateral trading system and the relationship between them".[13]

2.8 Later in 1996, the WTO Membership expressed its views on RTAs and the role of the CRTA in paragraph 7 of the Singapore Ministerial Declaration, as follows:

> "We note that trade relations of WTO Members are being increasingly influenced by regional trade agreements, which have expanded vastly in number, scope and coverage. Such initiatives can promote further liberalization and may assist least-developed, developing and transition economies in integrating into the international trading system. In this context, we note the importance of existing regional arrangements involving developing and least-developed countries. The expansion and extent of regional trade agreements make it important to analyse whether the system of WTO rights and obligations as it relates to regional trade agreements needs to be further clarified. We reaffirm the primacy of the multilateral trading system, which includes a framework for the development of regional trade agreements, and we renew our commitment to ensure that regional trade agreements are complementary to it and consistent with its rules. In this regard, we welcome the establishment and endorse the work of the new Committee on Regional Trade Agreements. We shall continue to work through progressive liberalization in the WTO as we are committed in the WTO Agreement and Decisions adopted at Marrakesh, and in so doing facilitate mutually supportive processes of global and regional trade liberalization."[14]

2.9 The CRTA 1998 Report to the General Council is self-explanatory on the results so far achieved in its work.[15] Paragraph 6 of the Report, with respect to the examination of the agreements, reads:

> "In 1998, the Committee endeavoured to accelerate the examination of agreements which had already commenced, as well as to handle new agreements referred to it. The Committee has currently under its purview a total of 62 RTAs. To date, the examination of 54 RTAs have been referred to the Committee by the CTG, seven by the CTS and one by the CTD. Draft reports on the examination of 28 agreements are currently under consideration; for 13 other agreements, reports are being drafted or factual examinations are well engaged, while the first round of examination for the remaining 21 RTAs is scheduled for either the Committee's twentieth session or early in 1999 … Thus far, no report has been adopted."

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[10] WT/L/127.

[11] The CRTA is in charge of the examinations which were previously performed by separate working groups, one per agreement.

[12] These provisions also govern regional integration within the WTO.

[13] WT/L/127, para.1(d).

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

[15] WT/REG/7.

As concluding remarks, paragraph 15 of the CRTA 1998 Report states as follows:

> "… Despite its heavy workload and delays in the submission of certain relevant material, the Committee also made progress in examining RTAs. The need to move forward in the process of examination pursuant to WTO rules was recognized; however, progress in this regard was slowed, *inter alia*, by a lack of consensus on the interpretation of certain elements of those rules relating to RTAs. On systemic issues, the Committee held discussions on some important topics and identified different approaches to these subjects; the need to move forward in the discussion of systemic issues was also recognized."

B. Turkey's Trade Relations with the European Communities

1. Association between Turkey and the European Communities, and the GATT/WTO process[16]

2.10 On 12 September 1963, Turkey and the Council and member States of the then European Economic Community ("EEC") signed the *Ankara Agreement*,[17] which entered into force on 1 December 1964. The Ankara Agreement formed the basis of the Association (in the sense of Article 228 of the Treaty of Rome) between Turkey and the European Communities envisaging that its objectives would be reached through a customs union which would be established in three progressive stages: preparatory, transitional and final. Article 28 of the Ankara Agreement also left open "the possibility of the accession" of Turkey to the EEC. The Ankara Agreement itself contained the modalities of the preparatory stage of the Association.

2.11 The terms and conditions for the implementation of the transitional stage were defined in the 1970 *Additional Protocol* to the Ankara Agreement and in the 1971 *Interim Agreement*.[18] The provisions of the Interim Agreement entered into force on 1 September 1971 and the Additional Protocol entered into force on 1 January 1973. These texts provided for an extended transitional period running over 22 years and foresaw the establishment of a customs union by the end of 1995. The Additional Protocol provided for an asymmetrical liberalization of intra-trade, because of the disparity in levels of development between the parties: the European Communities were to abolish all duties and QRs on imports of industrial products from Turkey as from September 1971, while Turkey was to do so over the transitional period, according to a timetable.[19] The Protocol also contained provisions designed to ensure the alignment of Turkey on EC policies in many areas (commercial policy, standards, competition, state aids, trade in services, etc.).

2.12 *Supplementary Protocols* to the Ankara Agreement (and Interim Agreement) were also concluded in 1973 between Turkey and the European Communities, containing adaptation and transition measures following the accession to the European Communities of Denmark, Ireland and the United Kingdom.[20]

2.13 Starting in 1973, Turkey embarked in the gradual alignment of its customs duties to the EC Common Customs Tariff ("CCT"), as scheduled. The implementation of Turkey's obligations arising out of its Association with the European Communities was interrupted during a number of years, due *inter alia* to the crisis in which the Turkish economy was engulfed following the oil

[16] The official titles of the agreements have changed over time The European Communities is a WTO Member.
[17] GATT document L/2155/Add.1.
[18] GATT document L/3554.
[19] Other agreements concluded at the time by the EC with Mediterranean countries contained similar provisions.
[20] GATT document L/3980.

shocks of 1973 and 1979. In 1987, when Turkey requested accession to the European Communities, completion of the customs union was seen as part of a package of measures designed to help Turkey prepare for membership. In 1988, Turkey resumed the reduction of its customs duties and alignment on the CCT.

2.14 The Ankara Agreement and the subsequent instruments concluded in the context of the Association between Turkey and the European Communities during the 1970s were notified to the GATT Contracting Parties under Article XXIV:7 of GATT 1947. The GATT entrusted three separate working parties with the task of examining the different agreements in light of those provisions. Reports of these working parties were adopted by the GATT Council:

(i) Report of the Working Party on the Ankara Agreement, adopted on 25 March 1965 (BISD 13S/59-64);

(ii) Report of the Working Party on the Additional Protocol, adopted on 25 October 1972 (BISD 19S/102-109); and

(iii) Report of the Working Party on the Supplementary Protocols, adopted on 21 October 1974 (BISD 21S/108-112).

2.15 As agreed at a meeting of the Turkey-EC Association Council ("Association Council") held in November 1992,[21] negotiations were initiated between the two parties on the modalities for the completion of the customs union, i.e. for the final phase of the Association. These negotiations were conducted from 1993 to 1995.

2.16 On 6 March 1995, the Association Council took *Decision 1/95*, to enter into force on 1 January 1996.[22] Decision 1/95 set out the modalities for the final phase of the Association between Turkey and the European Communities. In addition to the elimination of customs duties and alignment on the CCT, it contained provisions for the harmonisation of Turkey's policies and practices in all areas covered by the Association where this was deemed necessary "for the proper functioning of the Customs Union". In accordance with Article 65 of Decision 1/95 the parties were to consider, before entry into force, whether those harmonisation provisions (in particular those contained in Article 12) had been fulfilled. Once this requirement was considered satisfied, at a meeting of the Association Council on 30 October 1995, Decision 1/95 was submitted to the European Parliament for its approval and subsequently formally adopted by the Association Council on 22 December 1995. On 22 December 1995, the Association Council also adopted Decision 2/95, in pursuance of Article 15 of Decision 1/95. Decision 2/95 defined the coverage of products for temporary exception from Turkey's application of the CCT in respect of third countries, and fixed the timetable for their alignment to the CCT (from 1 January 1996 to 1 January 2001).

2.17 The entry into force of "the final phase of the Customs Union" between Turkey and the European Communities was notified to the WTO on 22 December 1995, under Article XXIV of GATT.[23] The texts of Decision 1/95 and Decision 2/95 were distributed to Members on 13 February 1996.[24] On 29 January 1996, the CTG adopted standard terms of reference for the

[21] The Association Council was created by the Ankara Agreement, as the only decision-making body of the Turkey-EC Association.
[22] Decision 1/95 is reproduced in WT/REG22/1.
[23] WT/REG22/N/1.
[24] WT/REG22/1 and WT/REG22/2, respectively.

examination of the "Customs Union between Turkey and the European Community"[25] ("Turkey-EC customs union"), and referred such examination to the CRTA.[26]

2.18 Turkey and the European Coal and Steel Community ("ECSC") signed an Agreement on 25 July 1996, which entered into force on 1 August 1996.[27] In their joint communication to the WTO, the parties stated that the Agreement was "intended as the complement to the Customs Union in respect of products covered by the European Coal and Steel Community and as a transitional arrangement in respect of such products until … the year 2002".[28]

2.19 On 30 October 1996, Turkey and the European Communities submitted preliminary information to the WTO on "the final phase of the Customs Union", in accordance with the Standard Format for Information on Regional Trade Agreements.[29] In a joint communication dated 24 November 1997,[30] Turkey and the European Communities provided, "[t]o assist Members in the examination of the Customs Union, … details of the quantitative limits applied by Turkey in respect of imports of certain textile and clothing products from certain WTO Members", including the levels of such quantitative limits for 1997.[31] The CRTA met twice to examine, in the light of the relevant provisions of GATT, the Turkey-EC customs union: on 23 October 1996 and on 1 October 1997.[32] Additional written questions from Members were also replied to by the parties.[33] To date, the CRTA has not yet finalized its examination.

(…)

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

1. Historical background

2.25 The gradual removal of QRs in major developed countries during the 1950s, in the wake of general liberalization efforts pursued in the GATT, brought about substantial increases in textiles and clothing imports into major developed countries originating in low-cost countries. To alleviate the difficulties caused to their producers, some importing countries convinced exporters of cotton textiles to conclude voluntary export restraint agreements. In an attempt to find a multilateral solution to the problem, in 1960 the GATT CONTRACTING PARTIES recognized the phenomenon of market disruption, thus setting the ground for selective safeguard action in the area of textile and clothing products (as a departure from the requirements of Article XIX of GATT 1947).

2.26 Thereafter, discriminatory restraints took the form of the 1961 Short-Term Arrangement Regarding International Trade in Cotton Textiles, followed in 1962 by the Long-Term Cotton Textiles Arrangement (1962-1973). The Arrangement Regarding International Trade in Textiles or Multifibre Arrangement ("MFA") entered into force in 1974, extending the coverage of the

[25] The terms of reference for the examination are contained in WT/REG22/4. In this Panel report we shall refer to the Turkey-EC customs union without any assessment of the WTO nature of this Article XXIV type of arrangement.
[26] G/C/M/8.
[27] WT/REG22/1/Add.1.
[28] WT/REG22/N/1/Add.1.
[29] WT/REG22/5.
[30] WT/REG22/7.
[31] A similar communication was circulated to Members on 28 July 1998, containing the levels of the quantitative limits in 1998 (Document WT/REG22/8).
[32] See WT/REG22/M/1 and WT/REG22/M/2 (Notes on the meetings).
[33] WT/REG22/6 and WT/REG22/6/Add.1.

restrictions on textiles and clothing from cotton products, to include wool and man-made fibre products (and, from 1986, certain vegetable fibre products).[34]

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

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

2.29 Turkey became a member of the MFA, as an exporting country, in 1981. Since 1979, Turkish textile and clothing products were subjected to restraints in the EC market under the provisions of Article 60 of the Additional Protocol to the Ankara Agreement.[35]

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

2. Recent background

2.31 In accordance with Article 13 of Decision 1/95, as of 1 January 1996, the customs duties applied by Turkey to the industrial goods imported from third countries were harmonized with the CCT and the previous Mass Housing Fund levy of some 20 per cent, collected from industrial goods, was abolished. With respect to imports of textile and clothing products, the MFN tariffs applied by Turkey were thereby reduced from roughly 10 per cent for textiles and 14 per cent for clothing in 1994 (*plus* the Mass Housing Fund levy) to 9 per cent in 1996.[36]

2.32 Decision 1/95 included specific provisions with respect to trade in textiles and clothing, in particular in Article 12, supplemented by related statements by both parties. Such provisions called for Turkey's adoption of the relevant EC regulations concerning imports of textiles and clothing, in particular Council Regulation 3030/93, which provided for the bilateral agreements with supplier countries to be implemented by a set of EC quantitative limits on certain imports and for a system of import surveillance.

2.33 Two Decrees issued by Turkey's Council of Ministers laid down the basis for the alignment of Turkish commercial policy in textiles and clothing to that of the European Communities: Decree No. 95/6815 on *Surveillance and Safeguard Measures for Imports of Certain Textiles Products*, with respect to products from countries with which Turkey concluded

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

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

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

bilateral agreements, and Decree No. 95/6816, concerning the *Surveillance and Safeguard Measures for Imports of Textile Products Originating in Certain Countries not Covered by Bilateral Agreements, Protocols and other Arrangements*, both of which were dated 30 April 1995 and published in the Turkish *Official Gazette* on 1 June 1995. Both Decrees were published with the respective Regulations for their application, under the authority of the Under-Secretariat for Foreign Trade, the Turkish responsible body for determination and calculation of the quota levels on imports of textile and clothing products.

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

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

2.36 Agreements providing for restraints similar to those of the European Communities were negotiated by Turkey with 24 countries (WTO Members and non-Members). As provided for in Article 12 of Decision 1/95, the EC Commission cooperated with the Turkish authorities in the preparation of negotiating positions and generally participated in the negotiations themselves. As from 1 January 1996, unilateral restrictions or surveillance regimes were applied to imports originating in another 28 countries (WTO Members and non-Members), including India, with which Turkey could not reach agreement. These restrictions only affected products whose export to the European Communities was also under restraint.

2.37 The quantitative limits established by Turkey for 1996 were allocated on a quarterly basis, through Communiqués published in the *Official Gazette* on 19 December 1995, 13 March, 13 June and 25 September 1996. Quantitative limits for 1997 were allocated on a half-year basis, through Communiqués published in the *Official Gazette* on 7 December 1996 and 12 June 1997. Quantitative limits for the year 1998 were allocated through a Communiqué published in the *Official Gazette* on 18 December 1997.

3. Quantitative limits imposed on certain Turkey's imports of textile and clothing products from India

2.38 Turkey applies QRs, as of 1 January 1996, on imports from India of 19 categories of textile and clothing products. (See the Annex to this report, Appendix 1, for a list of the categories and description of products.)

(…)

IX. FINDINGS

(…)

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

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

1. Articles XI and XIII of GATT

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

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

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

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

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

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

negotiations. In the sector of textiles and clothing, quantitative restrictions were maintained under the Multifibre Agreement (further discussed below). Certain contracting parties were even of the view that quantitative restrictions had gradually been tolerated and accepted as negotiable and that Article XI could not be and had never been considered to be, a provision prohibiting such restrictions irrespective of the circumstances specific to each case. This argument was, however, rejected in an adopted panel report *EEC – Imports from Hong Kong*.[37]

9.65 Participants in the Uruguay Round recognized the overall detrimental effects of non-tariff border restrictions (whether applied to imports or exports) and the need to favour more transparent price-based, i.e. tariff-based, measures; to this end they devised mechanisms to phase-out quantitative restrictions in the sectors of agriculture and textiles and clothing. This recognition is reflected in the GATT 1994 Understanding on Balance-of-Payments Provisions[38], the Agreement on Safeguards[39], the Agreement on Agriculture where quantitative restrictions were eliminated[40] and the Agreement on Textiles and Clothing (further discussed below) where MFA derived restrictions are to be completely eliminated by 2005.

9.66 The measures at issue, on their face, impose quantitative restrictions on imports and are applicable only to India.[41] We consider that, given the absence of a defense by Turkey (other than its defense based on Article XXIV of GATT) to India's claims that discriminatory import restrictions have been imposed, India has made a *prima facie* case of violation of Articles XI[42] and XIII of GATT.

(…)

3. Conclusions on India's claims under Articles XI and XIII of GATT, and Article 2.4 of the ATC

9.86 Consequently, unless the measures under examination are justified by Article XXIV (Turkey's defense that we examine below) they are inconsistent with the provisions of Articles XI and XIII of GATT and they would necessarily violate also Article 2.4 of the ATC.[43]

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

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[37] Panel Report on *EEC – Quantitative Restrictions Against Imports of Certain Products from Hong Kong*, adopted on 12 July 1983, BISD 30S/129, ("*EEC – Imports from Hong Kong*").

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

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

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

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

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

[43] The Panel is aware of the Appellate Body statement in *EC - Bananas III* that when two provisions are both applicable, a panel should proceed to apply the more specific provision first. However, such an exercise is not necessary here as what is examined is the relationship between Article XXIV and quantitative restrictions (either under Articles XI and XIII of GATT or the ATC).

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

9.88 Turkey argues that the measures at issue do not violate Articles XI and XIII of GATT or Article 2.4 of the ATC because they were implemented in relation to the formation of its customs union with the European Communities, which it considers to be compatible with the provisions of Article XXIV of GATT. For Turkey, the provisions of Article XXIV are concerned with the scope of application of GATT, both generally and in particular circumstances. As such, Article XXIV should not be regarded as a "justification", a "defense", an "exception" or a "waiver". In Turkey's view, the special nature of Article XXIV is evidenced by the fact that Article XXIV is in Part III of GATT, and not in Part II together with other provisions on commercial policies. For Turkey, Article XXIV, paragraphs 5 to 9, is to be viewed as *lex specialis* for the rights and obligations of WTO Members at the time of formation of a regional trade agreement. In other words, in Turkey's view, the WTO consistency of the measures challenged by India depends on the WTO consistency of the Turkey-EC customs union (of which they are an integral part) and the WTO consistency of both the customs union and its measures is to be determined with reference to the provisions of paragraphs 5 to 9 of Article XXIV only and no other GATT provisions.

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

9.90 In order to analyze Turkey's arguments, which we consider are properly labelled a defense[44] to India's claims, we firstly recall certain basic interpretative principles applicable in WTO dispute settlement proceedings. Secondly, we examine the provisions of Article XXIV generally. Thirdly, we consider the meaning of Article XXIV:5 and, finally that of Article XXIV:8, which constitute the heart of Turkey's defense to India's claims.

1. General Interpretative Principles

(a) Vienna Convention on the Law of Treaties

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

[44] We note, from our research, that during the negotiation of Article XXIV, participants typically referred to Article XXIV as an "exception" for customs unions and free-trade areas. See also footnote 287 above.

customary practices followed by CONTRACTING PARTIES to GATT 1947 and the bodies established in the framework of GATT 1947".[45]

(b) WTO rules on conflicts

9.92 As a general principle, WTO obligations are cumulative and Members must comply with all of them at all times unless there is a formal "conflict" between them. This flows from the fact that the WTO Agreement is a "Single Undertaking".[46] On the definition of conflict, it should be noted that:

> "… a conflict of law-making treaties arises only where simultaneous compliance with the obligations of different instruments is impossible. ... There is no conflict if the obligations of one instrument are stricter than, but not incompatible with, those of another, or if it is possible to comply with the obligations of one instrument by refraining from exercising a privilege or discretion accorded by another."[47]

9.93 This principle, also referred to by Japan in its third party submission,[48] is in conformity with the public international law presumption against conflicts which was applied by the Appellate Body in *Canada – Periodicals*[49] and in *EC – Bananas III*[50], when dealing with potential overlapping coverage of GATT 1994 and GATS, and by the panel in *Indonesia – Autos*[51], in respect of the provisions of Article III of GATT, the TRIMs Agreement[52] and the SCM Agreement.[53] In *Guatemala – Cement*[54], the Appellate Body when discussing the possibility of conflicts between the provisions of the Anti-dumping Agreement[55] and the DSU, stated: "A special or additional provision should only be found to *prevail* over a provision of the DSU in a situation where adherence to the one provision will lead to a violation of the other provision, that is, in the case of a *conflict* between them."

9.94 We recall the Panel's finding in *Indonesia – Autos*, a dispute where Indonesia was arguing that the measures under examination were subsidies and therefore the SCM Agreement being *lex specialis*, was the only "applicable law" (to the exclusion of other WTO provisions):

> "14.28 In considering Indonesia's defence that there is a general conflict between the provisions of the SCM Agreement and those of Article III of GATT, and consequently that the SCM Agreement is the only applicable law, we recall first that in public international law there is a presumption against conflict.[56] This

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[45] See Appellate Body Report on *Japan – Alcoholic Beverages*, p. 14.
[46] See the Appellate Body statement in *Brazil – Desiccated Coconut*, page 12. The WTO is a single undertaking except for the plurilateral agreements for the non-signatories.
[47] Wilfred Jenks, "The Conflict of Law-Making Treaties", The British Yearbook of International Law (1953) at p. 426-427.
[48] See para. 7.22 above.
[49] Appellate Body Report on *Canada – Certain Measures Concerning Periodicals*, adopted on 30 July 1997, WT/DS31/AB/R, ("*Canada - Periodicals*"), page 19.
[50] Appellate Body Report on *EC - Bananas III*, paras. 219-222.
[51] Panel Report on *Indonesia – Autos*, para. 14.28.
[52] The Agreement on Trade-Related Investment Measures.
[53] The Agreement on Subsidies and Countervailing Measures.
[54] Appellate Body Report on *Guatemala – Cement*, para.65.
[55] The Agreement on the Implementation of Article VI of GATT 1994.
[56] [Footnote original]In international law for a conflict to exist between two treaties, three conditions have to be satisfied. First, the treaties concerned must have the same parties. Second, the treaties must cover the same substantive subject matter. Were it otherwise, there would be no possibility for conflict. Third, the provisions must conflict, in the sense that the provisions must impose mutually exclusive obligations. "... [T]echnically speaking, there is a conflict when two (or more) treaty instruments contain obligations which

presumption is especially relevant in the WTO context[57] since all WTO agreements, including GATT 1994 which was modified by Understandings when judged necessary, were negotiated at the same time, by the same Members and in the same forum. In this context we recall the principle of effective interpretation[58] pursuant to which all provisions of a treaty (and in the WTO system all agreements) must be given meaning, using the ordinary meaning of words."

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

(c) Principle of effective interpretation

9.96 Finally we would also like to recall the principle of effective interpretation[59] whereby all provisions of a treaty must be, to the extent possible, given their full meaning so that parties to such a treaty can enforce their rights and obligations effectively. We note that the Appellate

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cannot be complied with simultaneously. ... Not every such divergence constitutes a conflict, however. ... Incompatibility of contents is an essential condition of conflict". (7 Encyclopædia of Public International Law (North-Holland 1984), page 468). The *lex specialis derogat legi generali* principle "which [is] inseparably linked with the question of conflict"(Idem., page 469) between two treaties or between two provisions (one arguably being more specific than the other), does not apply if the two treaties ".. deal with the same subject from different points of view or [is] applicable in different circumstances, or one provision is more far-reaching than but not inconsistent with, those of the other" (Wilfred Jenks, "The Conflict of Law-Making Treaties", The British Yearbook of International Law (BYIL) 1953, at 425 *et seq.*). For in such a case it is possible for a state which is a signatory of both treaties to comply with both treaties at the same time. The presumption against conflict is especially reinforced in cases where separate agreements are concluded between the same parties, since it can be presumed that they are meant to be consistent with themselves, failing any evidence to the contrary. See also E.W. Vierdag, "The Time of the "Conclusion" of a Multilateral Treaty: Article 30 of the Vienna Convention on the Law of Treaties and Related Provisions ", BYIL, 1988, at 100; Sir Robert Jennings/Sir Arthur Watts (ed.), Oppenheim's International Law, Vol. I., Parts 2 to 4, 1992, at 1280; Sir Gerald Fitzmaurice, "The Law and procedure of the International Court of Justice", BYIL , 1957, at 237; Sir Ian Sinclair, The Vienna Convention on the Law of Treaties, 1984, at 97.

[57] [Footnote original]In this context we note that the WTO Agreement contains a specific rule on conflicts which is however limited to conflicts between a specific provision of GATT 1994 and a provision of another agreement of Annex 1A. We do not consider this interpretative note in this section of the report because we are dealing with Indonesia's argument that there is a general conflict between Article III and the SCM Agreement, while the note is concerned with specific conflicts between a provision of GATT 1994 and a specific provision of another agreement of Annex 1A.

[58] [Footnote original]"This would correspond to the ruling of the Appellate Body when it stated that a treaty may not be interpreted so as to reduce whole clauses to "inutility". See footnote 649 *supra*."

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

Body has referred to this principle on several occasions.[60] We understand that this principle of interpretation prevents us from reaching a conclusion on the claims of India or the defense of Turkey, or on the related provisions invoked by the parties, that would lead to a denial of either party's rights or obligations.

2. Overview of Article XXIV of GATT

9.97 In examining of Article XXIV, we are well aware that regional trade agreements have greatly increased in number and importance since the establishment of GATT 1947 and today cover a significant proportion of world trade.[61] We have also undertaken a detailed analysis of the negotiating history of Article XXIV. We note that the wording of Article XXIV is of sub-optimal clarity and has been the object of various, sometimes opposing, views among individual contracting parties and Members and in the literature. We are also aware that the economic and political realities that prevailed when Article XXIV was drafted, have evolved and that the scope of regional trade agreements is now much broader than it was in 1948. Pursuant to the Vienna Convention on the Law of Treaties, we begin our analysis of the terms of Article XXIV together with those of GATT 1947, GATT 1994, the 1994 Understanding on Article XXIV in their context and in the light of the object and purpose of the WTO Agreement, GATT, the ATC and the relevant provisions on regional trade agreements.

9.98 As a means of increasing freedom of trade, Article XXIV recognizes that, subject to certain conditions, customs unions and free-trade areas between WTO Members are desirable. To this end Article XXIV provides for the possibility that Members forming a customs union may depart, as to the trade between themselves, from the most-favoured nation principle, in conformity with the conditions of Article XXIV.[62] There are a number of indications of the broad desirability of Article XXIV agreements as a means of increasing freedom of trade. For example, paragraph 4 of Article XXIV provides that:

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

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

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

9.100 This is also reflected in paragraph 7 of the Singapore Ministerial Decision:[63]

> "7. We note that trade relations of WTO Members are being increasingly influenced by regional trade agreements, which have expanded vastly in number,

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[60] See for instance the statement of the Appellate Body in *United States – Standards for Reformulated and Conventional Gasoline*, adopted on 20 May 1996, WT/DS2/AB/R ("*US – Gasoline*"):"An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility"; also the Appellate Body Report on *Japan – Alcoholic Beverages*, p. 12; Appellate Body Report on *United States – Restrictions on Imports of Cotton and Man-Fibre Underwear*, adopted on 25 February 1997, WT/DS24/AB/R, p. 16.

[61] We refer to our discussion in paras. 2.2 to 2.9 above.

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

[63] See WT/MIN(96)/DEC.

scope and coverage. Such initiatives can promote further liberalization and may assist least-developed, developing and transition economies in integrating into the international trading system."

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

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

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

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

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

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

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

9.105 We note that, at the very beginning of Article XXIV:5, the use of the word "Accordingly" indicates that the conditional right to form a regional trade agreement has to be understood and interpreted within the parameters set out in paragraph 4, since the word "Accordingly" refers back to that paragraph, which is the only paragraph addressing customs unions and free-trade areas in Article XXIV that precedes paragraph 5. Thus, the purpose of such a regional trade agreement "should be to facilitate trade between constituent territories *and not to raise barriers to the trade of other Members with such territories*" (emphasis added). In addition, we note that paragraphs 5 (in its proviso), 6 and 8, in particular, contain requirements that such agreements must meet. We consider these requirements in more detail later.

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

> "(*a*) Any Member deciding to enter into a customs union or free-trade area, or an interim agreement leading to the formation of such a union or area, shall promptly notify the Members and shall make available to them such information regarding the

proposed union or area as will enable them to make such reports and recommendations to Members as they may deem appropriate."[64] (emphasis added)

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

"Review of Customs Unions and Free-Trade Areas

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

9.107 Traditionally in GATT, regional trade agreements were examined by working parties. In the WTO, such agreements are now examined by the Committee on Regional Trade Agreements (CRTA).[65] In the history of GATT, except in the case of the 1994 customs union between the Czech Republic and the Slovak Republic, the CONTRACTING PARTIES were never able to conclude whether or not a regional trade agreement was fully compatible with GATT. Today, under the WTO, Members have yet to conclude that a regional trade agreement is in full compliance with the WTO Agreement. In short, virtually all working party reports on regional trade agreements have been inconclusive.[66]

9.108 We note also that Article XXIV:10 of GATT provides for the possibility of an approval by WTO Members of a regional trade agreement that would not be fully compatible with the provisions of Article XXIV, if such a proposed regional trade agreement respects the key provisions of Article XXIV ("provided that such proposals lead to the formation of a customs union or a free-trade area in the sense of this Article").

3. Article XXIV:5(a)

(a) Arguments of the parties

9.109 Turkey claims that Article XXIV:5 of GATT 1994 authorizes the formation of a customs union, as defined by Article XXIV:8(a), provided that the conditions of Article XXIV:5(a) are met. Turkey argues that the provisions of Article XXIV:5(a) should be read as permitting, at the

[64] The rest of paragraph 7 reads: "(*b*) If, after having studied the plan and schedule included in an interim agreement referred to in paragraph 5 in consultation with the parties to that agreement and taking due account of the information made available in accordance with the provisions of sub-paragraph (a), the Members find that such agreement is not likely to result in the formation of a customs union or of a free-trade area within the period contemplated by the parties to the agreement or that such period is not a reasonable one, the Members shall make recommendations to the parties to the agreement. The parties shall not maintain or put into force, as the case may be, such agreement if they are not prepared to modify it in accordance with these recommendations."

[65] The examination of regional trade agreements is subject to the same law and similar modalities as they were under GATT; see para. 2.7 above.

[66] This is in part due to the GATT/WTO practice of decision-making by consensus whereby the consensus of contracting parties (including the parties to the regional trade agreement) was needed for a recommendation to be made in terms of Article XXIV:7(a). The impossibility for GATT CONTRACTING PARTIES and still today, WTO Members, to reach any such conclusion is also due, *inter alia*, to disagreement on the interpretation of Article XXIV.

time of the completion of a customs union, the introduction of restrictive regulations of commerce to the trade of third countries, provided that the overall incidence of duties and other regulations of commerce was not higher or more restrictive after the completion of the customs union than before. Turkey claims that the overall incidence of duties and other regulations of commerce of the constituent members of the Turkey-EC customs union is not higher or more restrictive after the completion of the customs union than before.

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

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

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

9.112 Turkey further argues that the derogation envisaged by Article XXIV:5 is not limited to a particular GATT rule, but encompasses all those rules from which a derogation is necessary to permit the formation of customs unions. In support of this argument, Turkey notes that the opening clause of Article XXIV:5 is drafted in language similar to the language used in the opening clause of Article XX: "the provisions of this Agreement shall not prevent the formation of customs unions provided that …". For Turkey, this wording demonstrates that the derogation refers to all the provisions of the GATT, and not just to those contained in Article II, which are more specifically mentioned in Article XXIV:6.[67]

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

9.114 India also refers the Panel to Article XXIV:6, as part of the context of paragraph 5, which recognizes that on the occasion of the creation of a customs union, tariff bindings may be increased. India argues that there is no corresponding mechanism for renegotiation and compensation for Members affected by the introduction or increase of quantitative restrictions which are otherwise WTO incompatible. For India, this is a logical consequence of the principle that increasing tariffs is not as such WTO incompatible, as tariffs are negotiable (and renegotiable

[67] In this context, Turkey recalls that it had offered to enter into negotiations to address India's concerns with regard to the change in its external trade regime, but that India had not wished to participate in such negotiations.

under Article XXVIII), whereas quantitative restrictions are in general prohibited and may only be imposed in circumstances narrowly defined in the WTO agreements. Given that rules governing quantitative restrictions are fundamentally different from the rules governing tariffs, there is no basis to apply Article XXIV:6 by analogy to quantitative restrictions. Moreover, for India, paragraph 4 of the GATT 1994 Understanding on Article XXIV makes it explicit that paragraph 6 of Article XXIV establishes the procedures to be followed when a Member forming a custom union proposes to increase a bound rate of duty. Had the Uruguay Round negotiators meant to extend Article XXIV:6 to quantitative restrictions, they would have formulated this provision accordingly.

9.115 According to Turkey, it could not be inferred from the fact that Article XXIV:6 only refers to increases of customs duty rates that the intention behind Article XXIV:5(a) is to prohibit the introduction of restrictive measures as part of a common regulation of commerce of a customs union. For Turkey, such an interpretation would be difficult to reconcile with Article XXIV:5(a), which provides a test for the GATT consistency of a customs union requiring, *inter alia*, that regulations of commerce of a customs union shall not on the whole be more restrictive than the regulations of commerce applicable in the constituent territories prior to the formation of the customs union. For Turkey, it would make little sense to provide for an evaluation of the overall incidence of regulations of commerce if, as India asserts, the regulations of commerce of the Turkey-EC customs union cannot be determined by pre-existing restrictive measures applied by the European Communities.

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

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

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

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

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

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

9.118 By requiring an examination of changes in applied duties, the provisions of Article XXIV:5(a) are made unambiguously distinct from those in Article XXIV:6, since the level of

applied duties, unlike bound tariffs, is not regulated in the WTO framework of rights and obligations. Since the analysis of applied duties is a basic tool in appraising the impact of actual border barriers on trade opportunities, we consider that the requirement of an overall assessment of the incidence of duties based on applied duties clearly points at the economic nature of the assessment under paragraph 5(a).

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

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

9.120 Thus, the terms of paragraph 5(a) of Article XXIV, as elaborated upon and clarified by the GATT 1994 Understanding on Article XXIV, provide for an "economic" test for assessing whether a specific customs union is compatible with Article XXIV. In the context of the overall assessment of the potential trade impact of any such customs union, (a task envisaged to be performed by the WTO membership through the CRTA[68]), duties and all regulations which existed in one or more of the constituent members and/or form part of the customs union treaty must be taken into account. While there is no agreed definition between Members as to the scope of this concept of "other regulations of commerce", for our purposes, it is clear that this concept includes quantitative restrictions. More broadly, the ordinary meaning of the terms "other regulations of commerce" could be understood to include any regulation having an impact on trade (such as measures in the fields covered by WTO rules, e.g. sanitary and phytosanitary, customs valuation, anti-dumping, technical barriers to trade; as well as any other trade-related domestic regulation, e.g. environmental standards, export credit schemes). Given the dynamic nature of regional trade agreements, we consider that this is an evolving concept.

9.121 We note that the language of paragraph 5(a) of Article XXIV is general and not prescriptive. While it authorizes the formation of customs unions, it does not contain any provision that either authorizes or prohibits, on the occasion of the formation of a customs union, the adoption of import restrictions otherwise GATT/WTO incompatible, by any of the parties forming this customs union. For example, the terms of paragraph 5(a) do not permit or prohibit or otherwise regulate increases of bound tariffs, which is an issue dealt with in paragraph 6 of Article XXIV. Rather, paragraph 5(a) provides for an economic assessment (to be performed by the WTO membership as a whole) of the overall effect of the applied tariffs and other regulations of commerce resulting from the formation of the customs union.[69] While the wording of paragraph 5(a) assumes that, as a result of a customs union, some (applied) duties may be higher, and/or other regulations of commerce may be more restrictive than before, it does not specify whether such a situation may occur only through GATT/WTO consistent actions or may occur through

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

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

GATT/WTO inconsistent actions. What paragraph 5(a) provides, in short, is that the effects of the resulting trade measures and policies of the new regional agreement shall not be more trade restrictive, overall, than were the constituent countries' previous trade policies.

9.122 In other words, we consider that the terms of paragraph 5(a) do not address the GATT/WTO compatibility of specific measures that may be adopted on the occasion of the formation of a new customs union. We note that the standard terms of reference used by the CRTA for the examination of regional trade agreements confirm that the CRTA, in its overall assessment, shall not determine the WTO compatibility of specific measures.[70] The terms of Article XXIV:5(a) only provide that, for a customs union to be compatible with Article XXIV of GATT and the 1994 GATT Understanding on Article XXIV, the overall impact of the applied tariffs and other regulations of commerce resulting from the formation of the customs union must not be more restrictive than that of its constituent members prior to its formation.

9.123 It is important to emphasize that this interpretation does not render paragraph 5(a) a nullity,[71] as suggested by Turkey. In terms of our reading of paragraph 5(a), it continues to play an important role in ensuring that the occasion of the formation of a customs union is not used to increase trade barriers overall, even if the parties' previous concessions allowed such an increase (e.g., in the case of increased applied rates below tariff levels bound by all parties). Indeed, that purpose is in fact emphasized by the focus on "applied", and not on bound, tariff rates.

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

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

Article XXIV:5(b)

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

[70] "This implies that a working party established to examine a notification under paragraph 7(a) of Article XXIV has the mandate to examine the incidence and restrictiveness of *all duties and regulations of commerce, in particular those governed by the provisions of the Agreements contained in Annex 1A of the WTO Agreement*. However, it should be kept in mind that the purpose of an examination in the light of paragraph 5(a) of Article XXIV *would not be to determine whether each individual duty or regulation existing or introduced on the occasion of the formation of a customs union is consistent with all provisions of the WTO Agreement*; it would be to ascertain whether on the whole the general incidence of the duties and other regulations of commerce has increased or become more restrictive.", Understanding read out by the Chairman of the Council for Trade in Goods - 20 February 1995, WT/REG3/1 (emphasis added).

[71] See our discussion on the general rule of effective interpretation in para. 9.96 above.

authorize constituent members of a customs union to adopt GATT-inconsistent measures. The same terms being used in paragraphs 5(a) and 5(b) should not lead to different interpretations.

Article XXIV:4

9.126 We also note that Article XXIV:4 provides that the purpose of a customs union should not be to raise barriers to the trade of other Members. While not expressed as an obligation, paragraph 4 (and its elaboration in the fifth paragraph of the Preamble of the GATT 1994 Understanding on Article XXIV) argues against an interpretation of paragraph 5(a) that would read into that paragraph an exception to GATT rules that prohibit specific trade barriers. This view is also expressed by Japan and Hong Kong, China in their third party submissions.[72] With the use of the term "Accordingly", the language of paragraph 4 is specially relevant to the application and interpretation of the provisions in paragraph 5, and argues against any interpretation in favour of exceptions or deviations (not elsewhere foreseen) to the general GATT prohibition against the use of quantitative restrictions. This is also noted by the Philippines.[73]

Article XXIV:6

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

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

Article XXIV:8

9.129 Another element relating to the context is the scope and ordinary meaning of the terms of sub-paragraph 8(a)(ii) which define how Members forming a customs union should act *vis-à-vis* third country Members. For our analysis of Article XXIV:8(a) we refer to our discussion in paragraphs 9.142 to 9.169 below, where we address Turkey's argument that it is required to adopt the EC's commercial trade policy including quantitative restrictions in the sector of textile and clothing products.

Article XXIV in Part III of GATT

9.130 An additional element relating to the context is the fact that Article XXIV is found in Part III of GATT, a section of GATT distinct from Part I and Part II. Part I contains the main foundations of GATT: the most-favoured nation clause (Article I) and the tariff commitments or bindings (Article II). Part II contains a set of disciplines, the purpose of which is mainly to

[72] See Japan's argument in para. 7.21 and Hong Kong, China's argument in para. 7.10 above.
[73] See para. 7.43 above.

ensure the effectiveness of the tariff commitments. This is evident from the prohibition against quantitative restrictions (Article XI) and the national treatment obligation (Article III). We note that Article XXIV is not listed with the general exceptions (Article XX) or the security exception (Article XXI), both of which are in Part II.

9.131 Turkey concludes from the positioning of Article XXIV in Part III, that Article XXIV constitutes a self-contained regime for the formation of regional trade agreements, i.e. if the requirements of Article XXIV are met, other GATT rules do not apply to measures related to the formation of a customs union.

9.132 We note that Part III contains different types of provisions, some of a more institutional nature (Article XXV for instance), others dealing with Members' basic rights, such as Article XXVIII, and Article XXIV. We also note that Article XXIV itself deals with various elements such as the territorial application of GATT, frontier traffic and customs unions and free-trade areas. We have examined thoroughly the negotiating history of Article XXIV which, however, is not instructive in this respect. There is no text associated with Part III that suggests that it is fundamentally different from Part II, although Parts II and III entered into force at different dates.[74] In the Havana Charter, the provisions on regional trade agreements were included in the commercial policy chapter in a section on special provisions (among which were the general exceptions found today in Article XX of GATT). Yet we are not aware that the provisions of the Havana Charter on customs unions were thought to be fundamentally different from those of GATT. We can read that the drafters were of the view that customs unions and free-trade areas (a concept that came in later in the negotiations) were of the nature of this so-called "exception" but the discussions are not illuminating on the scope or even the nature of this provision and the relevance of its "location" in the GATT. We hesitate to draw from this examination the conclusion proposed by Turkey.

9.133 Moreover, the interpretation advanced by Turkey which pertains to propose a test as to the treatment of measures that are associated with the "formation" of a customs union, is problematic. The temporal and substantive breadth of this concept would be crucial to the interpretation of Article XXIV under Turkey's argument, yet Article XXIV does not define such a concept.[75] There are important difficulties in relation to the interpretation of the term "formation" when considered in relation to the present case.[76] For us this argument of Turkey is not substantiated and we therefore reject it.

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

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[74] We recall also that in the *European Communities – Measures Affecting the Importation of Certain Poultry Products*, adopted on 23 July 1998, WT/DS69/7, the Appellate Body concluded that the prohibitions contained in Article XIII were applicable to negotiations taking pace pursuant to Article XXVIII, a provision also contained in Part III of GATT. Clearly provisions of Part III of GATT do not in themselves argue for a distinct regime from those contained in Part II of GATT.

[75] What would be the minimum required scope for measures to qualify as being part of the "formation"? Would all measures that lead to, or are alleged to lead to, harmonization of policies be covered? Should there be a minimum or maximum time-frame to determine such "formation" period? Should the formation be required to correspond to any announced transitional period of interim agreements?

[76] We note that Turkey's first agreement with the European Communities was signed on 12 September 1963; see paras. 2.10 to 2.13 above. We note in passing that this situation is not unusual and reflects the reality of the ways in which Article XXIV type agreements are negotiated and presented to the WTO Members. But it is also evident that the present wording of Article XXIV on interim agreements is not adequate and does not reflect the present realities of the way regional trade agreements are negotiated and presented to the CRTA.

9.134 We shall examine the wider context of Article XXIV:5(a) and 8(a) as well as the object and purpose of GATT and the WTO Agreement, together with the practice of GATT CONTRACTING PARTIES and WTO Members with regard to these provisions, after our examination of the wording of Article XXIV:8(a). So far, based on the ordinary meaning of the terms and their immediate context, we find that the language of Article XXIV:5(a) is not prescriptive as to whether a specific measure may be adopted on the occasion of the formation of a customs union. From the terms of Article XXIV:5(a) and their immediate context, we find that there is a basis for the provisions of the sub-paragraph 5(a) to be informed by, and interpreted consistent with, the language of paragraph 4 against the raising of trade barriers. Consequently, we find that there is no legal basis in Article XXIV:5(a) for the introduction of quantitative restrictions otherwise incompatible with GATT/WTO; the wording of sub-paragraph 5(a) does not authorize Members forming a customs union to deviate from the prohibitions contained in Articles XI and XIII of GATT or Article 2.4 of the ATC. We find that the terms of sub-paragraph 5(a) provide for a prohibition against the formation of a customs union that would be more restrictive, on the whole, than was the trade of its constituent members (even in situations where there are no WTO-incompatible measures).

4. Article XXIV:8

(a) Arguments of the parties

9.135 Turkey submits also that Article XXIV:8(a)(ii) requires it to apply to third countries the same regulations of commerce, including import restrictions as those applied by the European Communities to the same third countries, since the term *regulations of commerce* has traditionally been interpreted as incorporating quantitative restrictions.[77] For Turkey, this is precisely the reason why Article 12 of Decision 1/95 unequivocally envisages the wholesale adoption by Turkey of the European Communities' Common Commercial Policy Instruments, as well as the European Communities' Customs Code, in the area of textiles and clothing products, prior to the completion of the customs union. Article 12(1) specifies the external trade measures to be adopted by Turkey towards third countries, which constituted the critical mass of commercial policy regulations applied by the European Communities and appropriate measures are envisaged to prevent trade diversion to the European Communities over Turkey's customs territory.

9.136 In India's view, however, Article XXIV:8(a) merely defines the requirements to be fulfilled by a regional trade agreement to qualify as a customs union within the meaning of Article XXIV[78]. This provision could not reasonably be interpreted to imply that Members, in fulfilling that requirement, are entitled to ignore their WTO obligations, such as those prohibiting import restrictions from third Members. For India, Article XXIV:4 makes it clear that the purpose of a customs union is not to raise barriers to the trade of third countries.

9.137 India notes that while Turkey claims it is obliged by Article XXIV:8 to adopt common quantitative restrictions with the European Communities for textiles and clothing products, it is also claiming the right to follow divergent trade policy practices and to adopt different instruments in other areas. India notes in this respect differences *inter alia* in external trade policies on agriculture, steel and other sensitive industrial products, as well as in relation to anti-dumping, countervailing and safeguards measures. India also adds that there is additionally no requirement that Members fulfil the requirements of Article XXIV:8(a) immediately.

[77] See BISD 35S/293, para. 45.
[78] See India's argument in para. 6.86 and Turkey's response in para. 6.94 above.

9.138 For Turkey, India's interpretation of Articles XXIV:5 and XXIV:8(a)(ii) is overly restrictive. Turkey is of the view that any interpretation of Article XXIV which could lead to the conclusion that in certain circumstances, WTO Members with diverging external trade regimes were legally inhibited from forming a customs union, is in contradiction with the objective clearly stated in Article XXIV:4.

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

9.140 We understand that Turkey is referring to two different requirements: 1) the requirement that it adopt the European Communities' external textile policy in order to form a customs union compatible with Article XXIV:8(a)(ii), and 2) the requirement in its specific customs union agreement with the European Communities that it adopt that European Communities' policy. We shall examine the second requirement in paragraphs 9.178 to 9.182 of this Panel report.

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

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

(i) The terms of paragraph 8(a)

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

> "8. For the purposes of this Agreement:
>
> (*a*) A customs union shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that
>
> (i) duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated with respect to substantially all the trade between the constituent territories of the union or at least with respect to substantially all the trade in products originating in such territories, and,

(ii) subject to the provisions of paragraph 9, substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union;"

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

9.143 We note the definition of a customs union as being "the substitution of a single customs territory for two or more customs territories". The term "customs territory" is defined in paragraph 2 of Article XXIV as being:

"For the purposes of this Agreement a customs territory shall be understood to mean any territory with respect to which separate tariffs or other regulations of commerce are maintained for a substantial part of the trade of such territory with other territories."

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

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

9.146 The terms of sub-paragraph 8(a)(i) offer some flexibility to the constituent members of a customs union as also noted by Hong Kong, China.[79] The standard is that "substantially all the trade between the constituent territories" must be fully liberalized among the constituent Members. This, in practice, can be accomplished only by providing preferential treatment to goods originating in the constituent territories.[80] We are mindful that sub-paragraph 8(a)(i) is not directly relevant to this case, as India's claims do not concern any preferential treatment accorded by Turkey and the European Communities to each other as part of their customs union, but rather with the treatment of their trade with non-members of the customs union, i.e. Turkey's imposition of quantitative restrictions on Indian textiles and clothing.[81] This is an issue mainly for

[79] See para. 7.15 above.

[80] Thus, in our view, sub-paragraph 8(a)(i) authorizes, for example, the members of a customs union to grant each other treatment notwithstanding the provisions of Article I:1 of GATT. We note in this context the statement of the Appellate Body in *EC - Bananas III*, para. 191: "Non-discrimination obligations apply to all imports of like products, except when these obligations are specifically waived or are otherwise not applicable as a result of the operation of specific provisions of the GATT 1994, such as Article XXIV". This was also recognized in a prior non-adopted Panel Report on *EEC – Member States' Import Regimes for Bananas*, DS32/R, para. 358: " … it [Article XXIV] merely provides them [contracting parties] with a justification for not applying to imports originating in such a union or area the restrictive import measures that they were permitted to impose under other provisions of the General Agreement".

[81] We are aware of the statement of the Appellate Body in the *EC – Computer Equipment* which should be understood in the context of the internal market of the EC : "96.…. However, the European Communities constitutes a customs union, and as such, once goods are imported into any Member State, they circulate freely within the territory of the entire customs union. The export market, therefore, is the European Communities, not an individual Member State." This Appellate Body statement referred to the "constant prior practice" of the European Communities. However, we are not addressing the situation of the internal market of the European Communities or the trade relations between the European Communities and Turkey.

consideration in light of Article XXIV:8(a)(ii), and the relationship between the two sub-paragraphs 8(a)(i) and 8(a)(ii).

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

9.148 As Japan and Hong Kong, China stressed[82], we note at the outset that the terms of sub-paragraph 8(a)(ii) do not explicitly authorize Members of a customs union to violate GATT rules in their relations with non-constituent members. Nor do they implicitly require such a result. Indeed, the terms of sub-paragraph 8(a)(ii) allow for flexibility in the creation of a common commercial policy, as the standard used is that "substantially the same duties and other regulations of commerce are [to be] applied by each of the members of the [customs] union". We are aware that GATT CONTRACTING PARTIES and WTO Members have never reached agreement on the interpretation of the term "substantially" in the context of Article XXIV:8. The ordinary meaning of the term "substantially" in the context of sub-paragraph 8(a) appears to provide for both qualitative and quantitative components. The expression "substantially the same duties and other regulations of commerce are applied by each of the Members of the [customs] union" would appear to encompass both quantitative and qualitative elements, the quantitative aspect more emphasized in relation to duties.[83]

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

9.150 We note, however, in the terms of sub-paragraph 8(a)(i), the possibility for parties to a customs union to maintain certain restrictions of commerce on their trade with each other, including quantitative restrictions ("…where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX"). This implies that even for "substantially all trade originating in the constituent countries" to be covered (here, for instance, textile and clothing products), certain WTO compatible restrictions can be maintained. This implies that internal quantitative restrictions can be used in the event that only one of the constituent territories has in place a restriction on imports from third countries. If such pre-existing import restrictions were WTO compatible, the maintenance of an internal import restriction between the two constituent countries would ensure that the protection afforded by the original WTO compatible quota would not be circumvented. The maintenance of such an internal restriction can obviate the need for identical external trade policies. We note also that the plain meaning of the wording used in these two sub-paragraphs implies a difference in approach between efforts at internal trade

[82] See Japan's argument in para. 7.25 and Hong Kong, China's argument in para. 7.16 above.
[83] We have also examined the French and Spanish versions of Article XXIV which confirm that flexibility is left to the constituent members.

liberalization among constituent members of a customs union where the maintenance of some quantitative restrictions (as restrictive regulations of commerce) is explicitly permitted (see paragraph 8(a)(i)), and their respective external policies with third countries where paragraph 8(a)(ii) contains no specific authorization relating to the maintenance of quantitative restrictions.

9.151 Having said this, and recognizing such flexibility, many questions remain unanswered. We consider, however, that if the ideal situation were to be one where the policies of the constituent members are identical, there is nevertheless a wide range of possibilities left for Members to identify how they can form their customs union and to what extent and how, they should put in place their internal trade and their common foreign trade polices. Considering this wide range of possibilities, we are of the view that, as a general rule, a situation where constituent members have "comparable" trade regulations having similar effects with respect to the trade with third countries, would generally meet the qualitative dimension of the requirements of sub-paragraph 8(a)(ii). The possibility also exists of convergence across a very wide range of policy areas but with distinct exceptions in limited areas. The greater the degree of policy divergence, the lower the flexibility as to the areas in which this can occur; and vice-versa. In our view, our interpretation of sub-paragraph 8(a)(ii) allows Members to form a customs union, as in this case, where one constituent member is entitled to impose quantitative restrictions under a special transitional regime and the other constituent member is not.[84]

9.152 This interpretation seems to be confirmed by the effective practice of the Turkey-EC customs union. We note that in some sectors such as those relating to agriculture, steel etc, identical trade policies are not being applied by the constituent members. We note also that Decision 1/95 envisages that the European Communities may continue to apply its system of certificates of origin should Turkey fail to conclude agreements with third countries, similar to the agreements already in place between those countries and the European Communities.[85] Thus, there are administrative means, as stated by the United States[86], available to the European Communities and Turkey, and in particular rules of origin, as suggested by Hong Kong, China[87], in order to ensure that no trade diversion occurs, while respecting the parameters of sub-paragraph 8(a)(i) and at the same time of sub-paragraph 8(a)(ii), recalling that the two sets of policies under sub-paragraphs 8(a)(i) and 8(a)(ii) are distinct and the relationship between them is a flexible one.

9.153 Our interpretation of Article XXIV:8(a) is not such as to render Turkey's right to form a customs union a nullity. We note that Turkey's exports of textiles and clothing to the European Communities represent 40 per cent of its total exports to the European Communities. If Turkey wants to cover such trade and to ensure that it benefits from the advantages of the customs union,

[84] Our discussion of the flexibility offered by Article XXIV:8(a) is without prejudice to the further flexibility that may exist during the transition period of an interim agreement leading to a customs union.
[85] Article 12 of Decision 1/95 (WT/REG22/1) provides that: "2. In conformity with the requirements of Article XXIV of the GATT Turkey will apply as from the entry into force of this Decision, substantially the same commercial policy as the Community in the textile sector including the agreements or arrangements on trade in textile and clothing. The Community will make available to Turkey the cooperation necessary for this objective to be reached. 3.Until Turkey has concluded these arrangements, the present system of certificates of origin for the exports of textile and clothing from Turkey into the Community will remain in force and such products not originating from Turkey will remain subject to the application of the Communities Commercial Policy in relation to the third countries in question… In the absence of such modalities, the Community reserves the right to take, in respect of imports into its territory, any measure rendered necessary by the application of the said Arrangement."
[86] See the United States' argument in para. 7.112 above
[87] See Hong Kong, China's argument in para. 7.18 above.

it can do so and comply with sub-paragraph 8(a)(i). In its discussion of the interpretation and application of sub-paragraph 8(a)(ii), Turkey's reference to the fact that textiles and clothing represents 40 per cent of its trade with the European Communities, is therefore of no relevance. With regard to its external trade policies, calculations based on import statistics provided by Turkey to the Panel show that, in 1995, 1996 and 1997, (a) textile and clothing imports from all non-EC countries (including WTO Members and non-Members) into Turkey represented between 8 and 9 per cent of Turkey's total imports from those countries[88]; (b) imports from non-EC countries of the products covered by all categories under restriction by Turkey represented 4.5 per cent of Turkey's total imports from those countries[89]; and (c) imports from non-EC countries of the products covered by the 19 categories under restriction from India represented less than 3 per cent of Turkey's total imports from those countries.[90] It should be noted that the figures in (b) and (c) above, include both imports from WTO Members and non-Members. Thus, a variation in policy relevant to WTO Members on at most 4.5 per cent of Turkey's external trade, in any event of a temporary nature,[91] could not be considered in this case to jeopardise the requirement of Article XXIV:8(a)(ii) that substantially the same regulations of commerce are to be applied by Turkey and the European Communities to third countries. The fact that this proportion of trade is regulated in a different way by Turkey, cannot be seen to contradict the requirements of Article XXIV:8(a)(ii). As noted above, we consider that it is for the CRTA to assess the GATT/WTO compatibility of customs unions such as the Turkey-EC customs union and that in any case our terms of reference do not request us to do so. We, for our part, have endeavoured to ensure that our interpretation is not such as to prevent Turkey from exercising its WTO right to form a customs union.

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

(ii) Immediate context

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

(iii) Conclusion

9.156 We conclude, based on the ordinary meaning of its terms and their immediate context, that Article XXIV:8(a) does not address explicitly the issue of the GATT/WTO compatibility of the measures adopted by constituent members of a customs union in their effort to align substantially all their duties and regulations of commerce *vis-à-vis* third countries. In any case, we consider that, in

[88] See Table II.2 above.
[89] See paras. 2.41 and 2.42 above.
[90] This results from the fact that, Turkey as an important clothing manufacturer, imports mainly textile products and these are only partially represented in the restricted categories (only 6, out of the 19 categories, refer to textile yarn or fabrics). (See para. 2.46 above and Annex to this report, Appendix 1.)
[91] The European Communities' MFA-derived quantitative restrictions must be eliminated by 1 January 2005.

this case, Article XXIV:8(a)(ii) does not authorize Turkey, in forming a customs union with the European Communities, to introduce quantitative restrictions on textile and clothing products that would be otherwise incompatible with GATT/WTO, nor does it require that Turkey introduce restrictions on imports of textiles and clothing which would be inconsistent with other provisions of the WTO Agreement.

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

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

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

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

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

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

9.160 Already then it was clear to CONTRACTING PARTIES that the overall objective of GATT and for that matter, regional trade agreements, should not be to raise barriers to trade. This is also noted in the Philippines' submission.[92] This is reflected in the wording of the second sentence of paragraph 4 of Article XXIV:

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

and in the Preamble to GATT 1947:

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

9.161 At the conclusion of the Uruguay Round Members reiterated the same general objective and principles in the GATT 1994 Understanding on Article XXIV:

> *"Reaffirming* that the purpose of such agreements should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other

[92] See para. 7.41 above.

> Members with such territories; and that in their formation or enlargement the parties to them should to the greatest possible extent avoid creating adverse effects on the trade of other Members;"

and in the Preamble to the WTO Agreement:

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

9.162 We also recall the Singapore Ministerial Declaration:

> "7. … We reaffirm the primacy of the multilateral trading system, which includes a framework for the development of regional trade agreements, and we renew our commitment to ensure that regional trade agreements are complementary to it and consistent with its rules"

9.163 From the above cited provisions,[93] we draw two general conclusions for the present case. Firstly, the objectives of regional trade agreements and those of the GATT and the WTO have always been complementary, and therefore should be interpreted consistently with one another, with a view to increasing trade and not to raising barriers to trade, thereby arguing against an interpretation that would allow, on the occasion of the formation of a customs union, for the introduction of quantitative restrictions. Secondly, we read in these parallel objectives a recognition that the provisions of Article XXIV (together with those of the GATT 1994 Understanding on Article XXIV) do not constitute a shield from other GATT/WTO prohibitions, or a justification for the introduction of measures which are considered generally to be *ipso facto* incompatible with GATT/WTO. In our view the provisions of Article XXIV on regional trade agreements cannot be considered to exempt constituent members of a customs union from the primacy of the WTO rules. In this context we also note the Singapore Ministerial Declaration where Members stated: "We reaffirm the primacy of the multilateral trading system…".

(d) GATT/WTO practice

9.164 Turkey also refers to the practice of the GATT CONTRACTING PARTIES to support its view that, on the occasion of the creation of a customs union, individual GATT contracting parties and now WTO Members have been authorized to introduce new, otherwise GATT/WTO incompatible, import restrictions.[94] Article 31.3(b) of the VCLT provides that the "context" of a provision to be interpreted, includes "any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation". Article XVI:1 of the Agreement Establishing the WTO provides that the WTO shall be guided by the customary practices followed by the CONTRACTING PARTIES.

(…)

[93] We note that the wording of Article V of GATS refers to the same concepts.
[94] Turkey alludes to GATT practice, albeit not in great detail. See paras. 6.58 to 6.61 above.

9.169 In light of these positions taken by individual GATT contracting parties[95] before the entry into force of the WTO Agreement and therefore the ATC, we cannot conclude that there is "subsequent practice" (as that term is used in the VCLT) or "customary practices" (as used in Article XVI:1 of the WTO Agreement) that could be regarded as an agreement or acceptance (even implicit) that paragraphs 5(a) or 8(a)(ii) of Article XXIV authorize or require the introduction of otherwise GATT/WTO inconsistent measures upon the formation of a customs union. We recall, as noted in paragraph 9.71 above, that the ATC has put in place new disciplines regarding the introduction of quantitative restrictions in the sector of textiles and clothing whereby, as of 1 January 1995, the global level of quantitative restrictions in that sector could only decrease (setting aside the possibility for ATC compatible safeguards measures).

(e) Temporary nature of the Turkish quantitative restrictions

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

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

(f) The absence of recommendations pursuant to Article XXIV:7 of GATT

9.172 Turkey also argues that the fact that no Article XXIV:7 recommendation has ever been made to parties to a customs union to change or abolish any import restrictions, and in particular that no such recommendation has ever been made in respect of the previous Turkey-EC trade agreements, suggests that its measures are therefore WTO compatible. Turkey adds that up until now no contracting party or a WTO Member ever challenged measures similar to those under examination.

9.173 We recall that the European Communities made a similar argument before the panel in *EEC – Imports from Hong Kong* when it argued that quantitative restrictions had been accepted by contracting parties, that their violation had become negotiable and that this was tantamount to a tolerance:

[95] It is also worth recalling the conclusions of the following GATT Panel Report which, although not adopted, confirm that some contracting parties opposed interpretations such as those suggested by Turkey, thereby denying the existence of any international customary practice. In the non-adopted Panel Report on *EEC – Tariff Treatment of Citrus Products from Certain Mediterranean Countries*, L/5776, paras. 3.12-3.22, the EEC argued that the non-recommendations by Working Parties which had examined the Treaty of Rome itself and other related agreements constituted tacit acceptance by the CONTRACTING PARTIES as a whole as well as the individual contracting parties that these agreements were in conformity with the provisions of Article XXIV, and that therefore the United States could not contest its preferential trade agreement with the Mediterranean Region. The United States' statement in response to the European Communities' argument was that the failure of the CONTRACTING PARTIES to reject the agreements did not imply acceptance nor did it constitute a legal finding of GATT consistency with Article XXIV.

> "15.…This proved, according to the EC, that quantitative restrictions had become a general problem and had gradually come to be accepted as negotiable, and that Article XI could not and had never been considered to be a provision prohibiting residual restrictions irrespective of the circumstances specific to each case."

This argument was rejected by the panel. It further discussed the consequences of a situation where during many years there had been no challenge to such a measure:

> "28. With regard to Article XI … The Panel acknowledged that there exist quantitative restrictions which are maintained for other than balance-of-payments reasons. It recognized that restrictions had been in existence for a long time without Article XXIII ever having been invoked by Hong Kong in regard to the products concerned, but concluded that this did not alter the obligations which contracting parties had accepted under GATT provisions. Furthermore *the Panel considered it would be erroneous to interpret the fact that a measure had not been subject to Article XXIII over a number of years, as tantamount to its tacit acceptance by contracting parties*. In fact, contracting parties and in particular Hong Kong have made it clear that the discussions on quantitative restrictions which have taken place in the GATT over the years were without prejudice to the legal status of the measures or the rights and obligations of GATT contracting parties. The Panel observed that, while most of the measures had been notified to the GATT in the past, the measures on watches had not been notified.
>
> 29. The Panel considered the argument put forward by the European Communities that the principle referred to as "the law-creating force derived from circumstances" could be relevant in the absence of law. It found, however, that in the present case such a situation did not exist, *and the matter was to be considered strictly in the light of the provisions of the General Agreement*." (Emphasis added)

9.174 We agree with these findings. We note that until the adoption of paragraph 12 of the GATT 1994 Understanding on Article XXIV, it was not always clear whether specific measures adopted on the occasion of the formation of a customs union, could be challenged under Article XXII and XXIII of GATT. We note also that with regard to the interpretation of Article XXIV, the difficulty in securing a definitive interpretation from WTO Members because of the wide range of issues involved, and because Members are often parties to one or more regional trade agreements, and the rather unclear wording of Article XXIV, may explain the absence of challenges under GATT. However, we cannot draw any conclusion as to the GATT/WTO compatibility of the measures at issue on the basis of the absence of past challenges.

(g) Offer to negotiate

9.175 Turkey also argues that it offered compensation to India which, contrary to 24 other exporting countries, has consistently declined to accept to enter into negotiations towards a mutually agreed solution. India responds that the introduction of GATT/WTO-inconsistent quantitative restrictions is generally prohibited by the WTO Agreement, and not otherwise authorized by Article XXIV, and that it cannot be forced to accept compensation for a WTO illegal measure.

9.176 We note that Article XXIV:6 provides for a special procedure for renegotiation of tariff increases. This provision does not refer to any form of compensation for the introduction of quantitative restrictions. Indeed, we consider that members cannot be forced to negotiate or

accept compensation in respect of GATT/WTO incompatible quantitative restrictions. We also recall the conclusion of the panel in *EEC– Imports from Hong Kong* that quantitative restrictions prohibited by GATT, cannot be negotiated.

9.177 Therefore the Panel considers that the refusal of India to enter into negotiations with Turkey in respect of compensation does not undermine its right to challenge Turkey's measures.

(h) The requirements of the Turkey-EC Customs Union Agreement itself

9.178 Turkey also argues that it was "required"' by the very terms of its customs union agreement with the European Communities to adopt the WTO compatible import restrictions of the European Communities in the sector of textiles and clothing. In our view, however, a bilateral agreement between two Members, such as that between the European Communities and Turkey, does not alter the legal nature of the measures at issue or the applicability of the relevant GATT/WTO provisions.

9.179 We note also that Article 12.2 of Decision 1/95 (WT/REG22/1) provides:

> "2. In conformity with the requirements of Article XXIV of the GATT, Turkey will apply as from the entry into force of this Decision, *substantially the same commercial policy* as the Community in the textile sector including the agreements or arrangements on trade in textile and clothing. The Community will make available to Turkey the cooperation necessary for this objective to be reached."

It is clear to us that the italicised language indicates that Turkey has some flexibility under this provision.

9.180 We recall that in the *EC – Bananas III* dispute the European Communities raised similar arguments with regard to what it was required to do pursuant to the Lomé Convention with the ACP countries. The European Communities argued that the panel should not have examined the content of the Lomé Convention and should have deferred to the common understanding of the parties. In that case the panel and the Appellate Body did examine the Lomé convention (for the purpose of assessing the scope of the Lomé waiver) and concluded that unless explicitly authorized by the waiver the provisions of the Lomé convention could not alter the rights and obligations of WTO Members including those of the European Communities.

9.181 We note in this context the relevance of Article 41 of the VCLT, which provides that:

> "Two or more parties to a multilateral treaty may conclude an agreement to modify the treaty as between themselves alone if … (b) the modification in question is not prohibited by the treaty and (i) does not affect the enjoyment by the other parties of their rights under the treaty or the performance of their obligations".

9.182 Consequently, even if the Turkey-EC customs union agreement did require Turkey to adopt all EC trade policies, an issue that we do not have to address, we consider that such requirement would not be sufficient to exempt Turkey from its obligations under the WTO Agreement.

(i) Further considerations

9.183 Our analysis would not be complete without addressing the argument that when, prior to forming the customs union, a constituent member has a WTO right, that Member may, on the

occasion of the formation of a customs union, "pass" or "extend" such right to the other constituent members. We find that this proposition cannot be sustained for the following reasons.

9.184 We note that such a legal fiction or concept is not referred to in Article XXIV, in the WTO Agreement or in public international law.[96] The WTO system of rights and obligations provides, in certain instances, flexibility to meet the specific circumstances of Members. For instance, the ATC has grand-fathered certain MFA derived rights regarding import restrictions for specific Members and Articles XII, XIX, XX and XXI of GATT authorize Members, in specific situations, to make use of special trade measures. We consider that, even if the formation of a customs union may be the occasion for the constituent member(s) to adopt, to the greatest extent possible, similar policies, the specific circumstances which serve as the legal basis for one Member's exercise of such a specific right cannot suddenly be considered to exist for the other constituent members. We also consider that the right of Members to form a customs union is to be exercised in such a way so as to ensure that the WTO rights and obligations of third country Members (and the constituent Members) are respected, consistent with the primacy of the WTO, as reiterated in the Singapore Declaration.

9.185 On a further matter, we have provided above our legal analysis of Article XXIV:8(a)(ii). We would add a brief general observation on Turkey's claim that it was "required" to adopt exactly the same trade policies as those of the European Communities and consequently that the provisions of Article XXIV do not leave any alternative to Members which intend to form a customs union. If we were to hypothesize such a complete lack of flexibility in the terms of Article XXIV, and that Turkey's foreign trade regime in consequence had to be completely and immediately identical to that of the European Communities, in order to comply with the provisions of Article XXIV:8(a)(ii) (and further assuming that, as in the present case, the European Communities can but is not obliged to maintain quantitative restrictions on textiles and clothing whereas Turkey cannot), it would imply that the European Communities would have to align its textiles and clothing regime to that of Turkey and immediately phase-out its import restrictions. This would go against the clear wording of Article XXIV in that it would arguably prevent Turkey from exercising its right to form a customs union with the European Communities because in practice it appears inconceivable that the European Communities would proceed with such a customs union if the "price" were to be that it must phase out its quantitative restrictions regularly notified to the TMB (and eventually, as a result, have to raise tariffs substantially in order to maintain the same overall level of protection). Turkey itself has noted[97] that such a scenario "is almost certainly not feasible". We recall the international law principle of effective interpretation whereby all provisions of a treaty must be given their full meaning and must ensure the overall consistency of the treaty and its effective application. We consider that Members have a right, albeit conditional, to form regional trade agreements. Therefore, Turkey's argument

[96] See for instance, O'Connell, The Law of State Succession, Cambridge Press, 1956, Chapter V Extension of Treaties of the Successor State to Territory Incorporated where the author concludes that "… it would appear that treaties do not extend, as a general rule, and in the absence of clear intention to the contrary, to territories which remain after their incorporation invested with some degree or other of autonomy. The Permanent Mandates Commission reported in 1923 that 'the special international conventions entered into by a State do not apply *de jure* to territories in regard to which the state in question had been entrusted with a mandate, even when those conventions are applicable to contiguous territories placed under the sovereignty of the same state". See also Lasok, D., Lasok K., Law and Institutions of the European Union (1996), 6th ed., Vol.1; Jennings and Watts, Oppenheim's International Law (1996), 9th ed., Vol 1 (peace), Parts 2 to 4, p. 1261; Resolution on the White Paper "Preparing the Associated Countries of Central and Eastern Europe for Integration into the Internal Market of the Union", COM (95)0163-C4-0166/95, OJ No C141, p. 135, 1996/05/13; and Articles 15 and 29 of the VCLT.

[97] See para. 6.111 above.

cannot be sustained since it would produce the above absurd result, i.e. that the European Communities would be forced to choose between its ATC rights and a customs union with Turkey. Consequently, there must be another realistic interpretation of Article XXIV, and there is, that reconciles the various interests of Members. In our view, the conclusion we have reached does so, and respects legal principles of 1) interpretation against conflicts and 2) for an effective interpretation of treaties.

5. Conclusion

9.186 We have considered the proposition that Article XXIV is *lex specialis* and is purported to be a self-contained regime insulated from the other provisions of GATT and the WTO Agreement. We are not convinced by this argument. The relationship between Article XXIV and GATT/WTO seems to us to be self-evident from the wording and context of Article XXIV.

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

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

9.189 As we have noted, paragraphs 5 and 8 of Article XXIV provide parameters for the establishment and assessment of a customs union, but in doing so allow flexibility in the choice of measures to be put in place on the formation of a customs union. In this context we recall the use of the terms "substantially all the trade" and "substantially the same duties and other regulations of commerce". While the meaning of these terms is not precisely clear in relation to what and how much constitute "substantially", they do confirm clearly that in both cases the standard is not all. These provisions do not, however, address any specific measures that may or may not be adopted on the formation of a customs union and importantly they do not authorize violations of Articles XI and XIII, and Article 2.4 of the ATC. Moreover, we note that paragraph 6 of Article XXIV provides for a specific procedure for the renegotiation of tariffs which are

increased above their bindings upon formation of a customs union; no such provision exists for quantitative restrictions. To the Panel, if the introduction of WTO inconsistent quantitative restrictions were intended to be negotiable on the formation of a customs union, it would seem odd to us that an explicit procedure would exist for changes in GATT's preferred form of trade barrier (i.e. tariffs), while no procedure would be provided for negotiation of compensation connected with imposition of otherwise GATT inconsistent measures. We draw the conclusion that even on the occasion of the formation of a customs union, Members cannot impose otherwise incompatible quantitative restrictions.

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

9.191 Finally, we recall that the prohibitions against quantitative restrictions in the sector of textiles and clothing constitute a fundamental feature of the WTO Agreement which argues strongly against the introduction of any new such restrictions in that sector. Moreover, considering the flexibility offered by the possibility of "interim agreements" under Article XXIV[98] and the inherently transitional nature of quantitative import restrictions in the sector of textiles and clothing, we find that Turkey was in a position to avoid the violations of Articles XI and XIII[99] of GATT, and Article 2.4 of the ATC.

9.192 Consequently, we reject Turkey's defense that Article XXIV allows it to introduce, upon the formation of its customs union with the European Communities, quantitative restrictions on 19 categories of textile and clothing products, in violation of Articles XI and XIII of GATT and Article 2.4 of the ATC.

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[98] For the purpose of this dispute we need not to address further the distinction between an "interim agreement" leading to a customs union and a completed customs union. We indeed state in footnotes 241 and 285 that we do not have to assess the precise relationship of the Turkey-EC agreement with Article XXIV, e.g. whether it is a free-trade agreement or a customs union or an interim agreement leading to a free-trade area or customs union. In this dispute, Turkey claims that its regional trade agreement with the European Communities is a completed customs union. We therefore limit our discussion to responding to Turkey's defense and, as we state in paras. 9.146 to 9.151 above even for completed customs unions, we are of the view that Article XXIV:8(a) leaves flexibility to constituent members of a customs union so that Turkey did not have to violate Articles XI, XIII of GATT and Article 2.4 of the ATC.

[99] We note that even if the quantitative restrictions imposed by Turkey were to be justified under Article XXIV, such a justification of quantitative restrictions introduced in violation of Article XI of GATT could not necessarily permit a violation of Article XIII of GATT. The ATC authorizes discriminatory quantitative restrictions (contrary to Article XIII). In this case the quantitative restrictions imposed by Turkey are not imposed pursuant to the ATC (see our conclusion in para. 9.80). They were not imposed under Article 2.1, or Article 6 as a safeguard measure, or otherwise under any other explicit provision of the ATC. Even if Article XXIV were to justify a violation of Article XI of GATT, such quantitative restrictions would still have to respect the prescriptions of Article XIII. In light of the principle of judicial economy, we consider, however, that we do not need to discuss further, India's claims pursuant to Article XIII of GATT.

H. The Absence of Nullification and Impairment

9.193 In its second submission, Turkey also submits an additional defense to India's claims. Turkey argues that even if the Panel were to conclude that Turkey's measures violated provisions of the GATT and/or the ATC, India's claims should still be rejected as imports of textile and clothing products from India into Turkey have increased since the entry into force of the Turkey-EC customs union. For Turkey, India has, therefore, not suffered any nullification or impairment of its WTO benefits.

(…)

9.201 Article 3.8 of the DSU provides that:

> "In cases where there is an infringement of the obligations assumed under a covered agreement, the action is considered *prima facie* to constitute a case of nullification or impairment. This means that there is normally a presumption that a breach of the rules has an adverse impact on other Members parties to that covered agreement, and in such cases, it shall be up to the Member against whom the complaint has been brought to rebut the charge."

9.202 We recall that in *EC – Bananas III*,[100] the Appellate Body confirms that the principles established in *US – Superfund*:

> "… a demonstration that a measure has no or insignificant effects would not be a sufficient demonstration that the benefits accruing under that provision had not been nullified or impaired even if such a rebuttal were in principle permitted."[101]

are still most relevant to violations of provisions of GATT 1994.

9.203 We note that some of the statistics provided by Turkey appear to refer to the trade effects of Turkey's entire import policy on textile and clothing products, including the reduced tariffs on some categories. Other statistics refer to the impact of Turkey's import policy in general resulting from the creation of the customs union.[102] With reference to the specific statistics on the 19 categories under restrictions, these statistics show, and both parties agree, that imports of textiles and clothing from India into Turkey significantly declined in 1996 after a substantial increase in 1995.[103] Turkey argues, however, that the year 1995 is atypical because it had already begun to lower its import tariffs in preparation for the entry into force of the customs union.[104] India challenges this assertion[105] and argues that the level of its exports of textiles and clothing into Turkey was influenced by the evolution of the market itself as well as by the import regimes of other countries. In support of its view, India argues that for the non-restricted categories, its exports to Turkey also increased substantially in 1995 but did not decline in 1996.[106]

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[100] Appellate Body Report on *EC - Bananas III*, para. 253.
[101] Panel Report on *US – Superfund*, para. 5.1.9.
[102] See paras. 6.139 to 6.147 above.
[103] See paras 2.43 and 2.44, and Tables II.4 and II.5 above.
[104] See para. 6.147 above.
[105] See paras. 6.148 and 6.149 above.
[106] See para. 6.148 above and Table II.4 above.

9.204 We are of the view that it is not possible to segregate the impact of the quantitative restrictions from the impact of other factors. While recognizing Turkey's efforts to liberalize its import regime on the occasion of the formation of its customs union with the European Communities, it appears to us that even if Turkey were to demonstrate that India's overall exports of clothing and textile products to Turkey have increased from their levels of previous years, is would not be sufficient to rebut the presumption of nullification and impairment caused by the existence of WTO incompatible import restrictions. Rather, at minimum, the question is whether exports have been what they would otherwise have been, were there no WTO incompatible quantitative restrictions against imports from India. Consequently, we consider that even if the presumption in Article 3.8 of the DSU were rebuttable, Turkey has not provided us with sufficient information to set aside the presumption that the introduction of these import restrictions on 19 categories of textile and clothing products has nullified and impaired the benefits accruing to India under GATT/WTO.

9.205 As to Turkey's allegations that India has not fully utilized the quotas under examination[107], we recall the conclusion of the adopted panel report in *Japan – Leather* that the existence of quantitative restrictions should be presumed to cause nullification or impairment even if quotas are not fully utilized because they lead to increased transaction costs and would create uncertainties which could affect investment plans (or in this case, trade).

9.206 As to Turkey's arguments that India's refusal to accept compensation has broken the chain of causation, we consider that although parties should clearly favour a mutually acceptable settlement of their dispute as provided for under the DSU, such a solution must be one that is "mutually" acceptable. We can only take note that India considered that the offers by Turkey and the European Communities were not acceptable to it. We recall that when a WTO Member considers that its rights have been nullified by the actions of another Member it is entitled to initiate dispute settlement procedures envisaged in the DSU.[108] We reject therefore Turkey's argument that India's nullification and impairment of its WTO benefits have resulted from India's own action or absence thereof.

I. Our Main Findings Recalled

9.207 Without prejudice to our detailed analysis above, it may be helpful to provide a brief overview of our main findings. We have found that the measures at issue were Turkish measures, as they were adopted by the Turkish government at a date different from the EC measures, and they were applied and enforced by Turkey alone. In this context we ruled that the European Communities was not an essential party to this dispute, although we invited it to submit to us any relevant facts or arguments that it deemed appropriate. We found that the measures at issue had not been introduced under the ATC, but rather, as submitted by Turkey, in the context of the formation of its customs union with the European Communities. Therefore the matter at issue is not for the TMB and we have jurisdiction to adjudicate on it. We have also found that the measures were "new measures" pursuant to Article 2.4 of the ATC and that, unless they could be justified under a GATT provision, the discriminatory quantitative restrictions imposed by Turkey against the imports of 19 categories of textiles and clothing imports from India, would violate Articles XI and XIII of GATT and consequently Article 2.4 of the ATC.

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[107] See para. 6.164 above.

[108] See for instance the Appellate Body Report on *US – Shirts and Blouses*, p. 13, where it is stated: "If any Member should consider that its benefits are nullified or impaired as the result of circumstances set out in Article XXIII, then dispute settlement is available"; see also the Appellate Body Report on *EC - Bananas III*, paras. 136 and 252-253.

9.208 We then proceeded to examine Turkey's defense based on Article XXIV of GATT. In this context, we decided that we had jurisdiction to examine any specific measure adopted by a WTO Member in the context of a customs union but that, in this case, we did not need, and indeed we were asked by the parties not to assess the overall WTO compatibility of the Turkey-EC customs union. We have found that, as a general principle, Turkey was bound, at all times, by all WTO obligations, unless there was a conflict between any provisions. Since the wording of Articles XI and XIII of GATT and Article 2.4 of the ATC is clear in prohibiting the introduction of quantitative restrictions such as those at issue, we examined the terms of Article XXIV to decide whether Turkey could be exempted from the application of these prohibitions. We found that the provisions of paragraphs 5 and 8 of Article XXIV did not authorize any violation of the WTO obligations, other than the MFN obligation. Indeed, these paragraphs do not provide any indication as to the type of measure to be used in the formation of a customs union but rather provide guidelines for the overall assessment of regional trade agreements. We have therefore concluded that Article XXIV did not authorize the violation of Articles XI and XIII of GATT or Article 2.4 of the ATC. While reaching this conclusion on the basis of the wording of the provisions at issue, we have endeavoured to ensure that our interpretation did not render Turkey's right to form a customs union with the European Communities a nullity, since pursuant to Article XXIV:8(a)(ii), constituent members to a customs union are required to adopt substantially the same regulations of commerce. We found that this standard leaves flexibility to the constituent members. In any event, in the present case, taking into account, *inter alia*, the share of trade affected by the type of measures at issue (quantitative restrictions on textiles and clothing), we found that there were WTO compatible alternatives available to Turkey if it wanted to conclude a customs union with the European Communities. Finally we found that even if the presumption of nullification of Article 3.8 of the DSU were rebuttable, Turkey had not submitted evidence that the benefits accruing to India under the ATC and GATT had not been reduced or nullified by the introduction of WTO incompatible quantitative restrictions.

X. CONCLUSIONS

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

10.2 Under Article 3.8 of the DSU, in cases where there is infringement of the obligations assumed under a covered agreement, the action is considered *prima facie* to constitute a case of nullification or impairment of benefits under that agreement. Accordingly, we conclude that, to the extent that Turkey has acted inconsistently with the provisions of covered agreements, as described in the preceding paragraph, it has nullified or impaired the benefits accruing to the complainant under those agreements.

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

Report of the Appellate Body, WT/DS34/AB/R, 22 October 1999

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

I. INTRODUCTION

1. Turkey appeals from certain issues of law and legal interpretations in the Panel Report, *Turkey – Restrictions on Imports of Textile and Clothing Products* (the "Panel Report").[109] The Panel was established to consider a complaint by India regarding quantitative restrictions introduced by Turkey on imports of Indian textile and clothing products.

2. On 6 March 1995, the Turkey-EC Association Council adopted Decision 1/95[110], which sets out the rules for implementing the final phase of the customs union between Turkey and the European Communities. Article 12(2) of this Decision states:

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

In order to apply what it considered to be "substantially the same commercial policy" as the European Communities on trade in textiles and clothing, Turkey introduced, as of 1 January 1996, quantitative restrictions on imports from India on 19 categories of textile and clothing products.[111]

3. The Panel considered claims by India that the quantitative restrictions introduced by Turkey were inconsistent with Articles XI and XIII of the GATT 1994, and Article 2.4 of the Agreement on Textiles and Clothing (the "*ATC*"). In the Panel Report, circulated on 31 May 1999, the Panel reached the conclusion that the quantitative restrictions were inconsistent with the provisions of Articles XI and XIII of the GATT 1994 and consequently with those of Article 2.4 of the *ATC*, and rejected Turkey's defence that the introduction of any such otherwise GATT/WTO incompatible import restrictions is permitted by Article XXIV of the GATT 1994.[112]

(…)

IV. ISSUE RAISED IN THIS APPEAL

41. This appeal relates to certain quantitative restrictions imposed by Turkey on 19 categories of textile and clothing products imported from India. Turkey adopted these quantitative restrictions upon the formation of a customs union with the European Communities. The Panel found these quantitative restrictions to be inconsistent with Articles XI and XIII of the GATT 1994 and

[109]WT/DS34/R, 31 May 1999.

[110]Reproduced in WT/REG22/1.

[111]For a further discussion of the underlying facts and a more detailed description of the products involved in this case, see the Panel Report, paras. 2.2-2.46 and 4.1-4.3, and the Annex to the Report.

[112]Panel Report, para. 10.1.

Article 2.4 of the *ATC*.[113] The issue raised by Turkey in this appeal is whether these quantitative restrictions are nevertheless justified by Article XXIV of the GATT 1994.

V. ARTICLE XXIV OF THE GATT 1994

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

> With regard to the specific relationship between, in the case before us, Article XXIV and Articles XI and XIII (and Article 2.4 of the ATC), we consider that the wording of Article XXIV does not authorize a departure from the obligations contained in Articles XI and XIII of GATT and Article 2.4 of the ATC.
>
> …
>
> [Paragraphs 5 and 8 of Article XXIV] do not … address any specific measures that may or may not be adopted on the formation of a customs union and importantly they do not authorize violations of Articles XI and XIII, and Article 2.4 of the ATC. … We draw the conclusion that even on the occasion of the formation of a customs union, Members cannot impose otherwise incompatible quantitative restrictions.[114]

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

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

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

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

45. First, in examining the text of the chapeau to establish its ordinary meaning, we note that the chapeau states that the provisions of the GATT 1994 "*shall not prevent*" the formation of a customs union. We read this to mean that the provisions of the GATT 1994 *shall not make*

[113]Panel Report, para. 9.86.

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

impossible the formation of a customs union.[115] Thus, the chapeau makes it clear that Article XXIV may, under certain conditions, justify the adoption of a measure which is inconsistent with certain other GATT provisions, and may be invoked as a possible "defence" to a finding of inconsistency.[116]

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

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

> A customs union shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that
>
> (i) duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated with respect to *substantially all the trade* between the constituent territories of the union or at least with respect to substantially all the trade in products originating in such territories, and,
>
> (ii) … *substantially the same* duties and other regulations of commerce are applied by each of the members of the union to the trade of

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

[116]We note that legal scholars have long considered Article XXIV to be an "exception" or a possible "defence" to claims of violation of GATT provisions. An early treatise on GATT law stated: "[Article XXIV] establishes an *exception to GATT obligations* for regional arrangements that meet a series of detailed and complex criteria." (emphasis added) J. Jackson, *World Trade and the Law of GATT* (The Bobbs-Merrill Company, 1969), p. 576. See also J. Allen, *The European Common Market and the GATT* (The University Press of Washington, D.C., 1960), p. 2; K. Dam, "Regional Economic Arrangements and the GATT: The Legacy of Misconception", *University of Chicago Law Review*, 1963, p. 616; and J. Huber, "The Practice of GATT in Examining Regional Arrangements under Article XXIV", *Journal of Common Market Studies*, 1981, p. 281. We note also the following statement in the unadopted panel report in *EEC – Member States' Import Regimes for Bananas*, DS32/R, 3 June 1993, para. 358: "The Panel noted that Article XXIV:5 to 8 permitted the contracting parties to *deviate from their obligations under other provisions of the General Agreement* for the purpose of forming a customs union …". (emphasis added) The chapeau of paragraph 5 refers only to the provisions of the GATT 1994. It does not refer to the provisions of the *ATC*. However, Article 2.4 of the *ATC* provides that "[n]o new restrictions … shall be introduced *except under* the provisions of this Agreement or *relevant GATT 1994 provisions*." (emphasis added) In this way, Article XXIV of the GATT 1994 is incorporated in the *ATC* and may be invoked as a defence to a claim of inconsistency with Article 2.4 of the *ATC*, provided that the conditions set forth in Article XXIV for the availability of this defence are met.

> territories not included in the union. (emphasis added)

48. Sub-paragraph 8(a)(i) of Article XXIV establishes the standard for the *internal trade* between constituent members in order to satisfy the definition of a "customs union". It requires the constituent members of a customs union to eliminate "duties and other restrictive regulations of commerce" with respect to "substantially all the trade" between them. Neither the GATT CONTRACTING PARTIES nor the WTO Members have ever reached an agreement on the interpretation of the term "substantially" in this provision.[117] It is clear, though, that "substantially all the trade" is not the same as *all* the trade, and also that "substantially all the trade" is something considerably more than merely *some* of the trade. We note also that the terms of sub-paragraph 8(a)(i) provide that members of a customs union may maintain, where necessary, in their internal trade, certain restrictive regulations of commerce that are otherwise permitted under Articles XI through XV and under Article XX of the GATT 1994. Thus, we agree with the Panel that the terms of sub-paragraph 8(a)(i) offer "some flexibility" to the constituent members of a customs union when liberalizing their internal trade in accordance with this sub-paragraph.[118] Yet we caution that the degree of "flexibility" that sub-paragraph 8(a)(i) allows is limited by the requirement that "duties and other restrictive regulations of commerce" be "eliminated with respect to substantially all" internal trade.

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

> [t]he ordinary meaning of the term "substantially" in the context of sub-paragraph 8(a) appears to provide for both qualitative and quantitative components. The expression "substantially the same duties and other regulations of commerce are applied by each of the Members of the [customs] union" would appear to encompass both quantitative and qualitative elements, the quantitative aspect more emphasized in relation to duties.[119]

50. We also believe that the Panel was correct in its statement that the terms of sub-paragraph 8(a)(ii), and, in particular, the phrase "substantially the same" offer a certain degree of "flexibility" to the constituent members of a customs union in "the creation of a common commercial policy."[120] Here too we would caution that this "flexibility" is limited. It must not be forgotten that the word "substantially" qualifies the words "the same". Therefore, in our view,

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[117]Panel Report, para. 9.148.

[118]*Ibid*., para. 9.146.

[119]Panel Report, para. 9.148.

[120]*Ibid*.

something closely approximating "sameness" is required by Article XXIV:8(a)(ii). We do not agree with the Panel that:

> … as a general rule, a situation where constituent members have "comparable" trade regulations having similar effects with respect to the trade with third countries, would generally meet the qualitative dimension of the requirements of sub-paragraph 8(a)(ii).[121]

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

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

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

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

53. With respect to "duties", Article XXIV:5(a) requires that the duties applied by the constituent members of the customs union *after* the formation of the customs union "shall *not* on the whole be *higher* … than the *general incidence*" of the duties that were applied by each of the constituent members before the formation of the customs union. Paragraph 2 of the *Understanding on Article XXIV* requires that the evaluation under Article XXIV:5(a) of the *general incidence of the duties* applied before and after the formation of a customs union "shall … be based upon an overall assessment of weighted average tariff rates and of customs duties collected."[122] Before the agreement on this Understanding, there were different views among the GATT Contracting Parties as to whether one should consider, when applying the test of Article XXIV:5(a), the *bound* rates of duty or the *applied* rates of duty. This issue has been resolved by paragraph 2 of

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

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

the *Understanding on Article XXIV*, which clearly states that the *applied* rate of duty must be used.

54. With respect to "other regulations of commerce", Article XXIV:5(a) requires that those applied by the constituent members *after* the formation of the customs union "shall *not* on the whole be … *more restrictive* than the *general incidence*" of the regulations of commerce that were applied by each of the constituent members *before* the formation of the customs union. Paragraph 2 of the *Understanding on Article XXIV* explicitly recognizes that the quantification and aggregation of regulations of commerce other than duties may be difficult, and, therefore, states that "for the purpose of the overall assessment of the incidence of other regulations of commerce for which quantification and aggregation are difficult, the examination of individual measures, regulations, products covered and trade flows affected may be required."[123]

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

> … that the effects of the resulting trade measures and policies of the new regional agreement shall not be more trade restrictive, overall, than were the constituent countries' previous trade policies.[124]

and we also agree that this is:

> an "economic" test for assessing whether a specific customs union is compatible with Article XXIV.[125]

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

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

57. According to paragraph 4, the purpose of a customs union is "to facilitate trade" between the constituent members and "not to raise barriers to the trade" with third countries. This objective

[123]In paragraph 43 of its appellant's submission, Turkey argues that this provision must be interpreted as allowing the constituent members of a customs union to introduce GATT/WTO inconsistent quantitative restrictions upon the formation of the customs union. We see no basis for such an interpretation.

[124]Panel Report, para. 9.121.

[125]*Ibid*., para. 9.120.

demands that a balance be struck by the constituent members of a customs union. A customs union should facilitate trade within the customs union, but it should *not* do so in a way that raises barriers to trade with third countries. We note that the *Understanding on Article XXIV* explicitly reaffirms this purpose of a customs union, and states that in the formation or enlargement of a customs union, the constituent members should "to the greatest possible extent avoid creating adverse affects on the trade of other Members".[126] Paragraph 4 contains purposive, and not operative, language. It does not set forth a separate obligation itself but, rather, sets forth the overriding and pervasive purpose for Article XXIV which is manifested in operative language in the specific obligations that are found elsewhere in Article XXIV. Thus, the purpose set forth in paragraph 4 informs the other relevant paragraphs of Article XXIV, including the chapeau of paragraph 5. For this reason, the chapeau of paragraph 5, and the conditions set forth therein for establishing the availability of a defence under Article XXIV, must be interpreted in the light of the purpose of customs unions set forth in paragraph 4. The chapeau cannot be interpreted correctly without constant reference to this purpose.

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

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

60. More specifically, with respect to the first condition, the Panel, in this case, did not address the question of whether the regional trade arrangement between Turkey and the European Communities is, in fact, a "customs union" which meets the requirements of paragraphs 8(a) and 5(a) of Article XXIV. 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.[127] 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* on the jurisdiction of panels to review the justification of balance-of-payments restrictions under Article XVIII:B of the GATT 1994.[128] The Panel also considered that, on the basis of the principle of judicial economy, it was not necessary to assess the compatibility of the regional trade arrangement between Turkey and the European Communities with Article XXIV in

[126]*Understanding on Article XXIV*, Preamble.

[127]Panel Report, para. 9.53.

[128]Adopted 22 September 1999, WT/DS90/AB/R, paras. 80 – 109.

order to address the claims of India.[129] Based on this reasoning, the Panel assumed *arguendo* that the arrangement between Turkey and the European Communities is compatible with the requirements of Article XXIV:8(a) and 5(a) and limited its examination to the question of whether Turkey was permitted to introduce the quantitative restrictions at issue.[130] The assumption by the Panel that the agreement between Turkey and the European Communities is a "customs union" within the meaning of Article XXIV was not appealed. Therefore, the issue of whether this arrangement meets the requirements of paragraphs 8(a) and 5(a) of Article XXIV is not before us.

61. With respect to the second condition that must be met to have the benefit of the defence under Article XXIV, Turkey asserts that had it not introduced the quantitative restrictions on textile and clothing products from India that are at issue, the European Communities would have "exclud[ed] these products from free trade within the Turkey/EC customs union".[131] According to Turkey, the European Communities would have done so in order to prevent trade diversion. Turkey's exports of these products accounted for 40 per cent of Turkey's total exports to the European Communities.[132] Turkey expresses strong doubts about whether the requirement of Article XXIV:8(a)(i) that duties and other restrictive regulations of commerce be eliminated with respect to "substantially all trade" between Turkey and the European Communities could be met if 40 per cent of Turkey's total exports to the European Communities were excluded.[133] In this way, Turkey argues that, unless it is allowed to introduce quantitative restrictions on textile and clothing products from India, it would be prevented from meeting the requirements of Article XXIV:8(a)(i) and, thus, would be prevented from forming a customs union with the European Communities.

62. We agree with the Panel that had Turkey not adopted the same quantitative restrictions that are applied by the European Communities, this would not have prevented Turkey and the European Communities from meeting the requirements of sub-paragraph 8(a)(i) of Article XXIV, and consequently from forming a customs union. We recall our conclusion that the terms of sub-paragraph 8(a)(i) offer some – though limited – flexibility to the constituent members of a customs union when liberalizing their internal trade.[134] As the Panel observed, there are other alternatives available to Turkey and the European Communities to prevent any possible diversion of trade, while at the same time meeting the requirements of sub-paragraph 8(a)(i).[135] For example, Turkey could adopt rules of origin for textile and clothing products that would allow the European Communities to distinguish between those textile and clothing products originating in Turkey, which would enjoy free access to the European Communities under the terms of the customs union, *and* those textile and clothing products originating in third countries, including India. In fact, we note that Turkey and the European Communities themselves appear to have recognized that rules of origin could be applied to deal with any possible trade diversion. Article 12(3) of Decision 1/95 of the EC-Turkey Association Council, which sets out the rules for implementing the final phase of the customs union between Turkey and the European Communities, specifically provides for the possibility of applying a system of certificates of

[129]Panel Report, para. 9.54.

[130]*Ibid*., para. 9.55.

[131]Turkey's appellant's submission, para. 56.

[132]Panel Report, para. 9.153.

[133]Turkey's appellant's submission, para. 56

[134]*Supra*, para. 48

[135]Panel Report, para. 9.152.

origin.[136] A system of certificates of origin would have been a reasonable alternative until the quantitative restrictions applied by the European Communities are required to be terminated under the provisions of the *ATC*. Yet no use was made of this possibility to avoid trade diversion. Turkey preferred instead to introduce the quantitative restrictions at issue.

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

VI. FINDINGS AND CONCLUSIONS

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

65. We wish to point out that we make no finding on the issue of whether quantitative restrictions found to be inconsistent with Article XI and Article XIII of the GATT 1994 will *ever* be justified by Article XXIV. We find only that the quantitative restrictions at issue in the appeal in this case were not so justified. Likewise, we make no finding either on many other issues that may arise under Article XXIV. The resolution of those other issues must await another day. We do not believe it necessary to find more than we have found here to fulfill our responsibilities under the DSU in deciding this case.

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

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

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

3. Optional Reading

2005 WTO CONSULTATIVE BOARD REPORT (THE "SUTHERLAND REPORT")
Chapter 2: The Erosion of Non-Discrimination
http://www.wto.org/english/thewto_e/10anniv_e/future_wto_chap2_e.pdf

SUNGJOON CHO, BREAKING THE BARRIER BETWEEN REGIONALISM AND MULTILATERALISM: A NEW PERSPECTIVE ON TRADE REGIONALISM, 42 HARV. INT'L L. J. 419 (2001).

WTO SECRETARIAT, REGIONAL TRADE INTEGRATION UNDER TRANSFORMATION (2002)
http://www.wto.org/english/tratop_e/region_e/sem_april02_e/sem_april02_prog_e.htm

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Unites States - Definitive Safeguard Measures on Imports of Circular Welded Carbon Quality Line Pipe from Korea (*U.S. – Line Pipe*), WT/DS202/AB/R, Appellate Body Report circulated on Feb. 15, 2002 (http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds202_e.htm)

As for the principle of "parallelism" under the Safegurard Code Article 2.2 ("Safeguard measures shall be applied to a product being imported irrespective of its source."), the Appellate Body held that the U.S. violated the Article "by *including* Canada and Mexico in the analysis of whether increased imports caused or threatened to cause serious injury, but *excluding* Canada and Mexico from the application of the safeguard measure, without providing a reasoned and adequate explanation that establishes explicitly that imports from non-NAFTA sources by themselves satisfied the conditions for the application of a safeguard measure." (para. 197, *emphasis added*). However, it refused to go further and address GATT Article XXIV issues. (para. 199)

Brazil — Measures Affecting Imports of Retreaded Tyres (Brazil – Retreaded Tyres), WT/DS332/R, Panel Report circulated on June 12, 2007
(http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds332_e.htm)
See also **ASIL Insights** by Julia Qin (http://asil.org/insights/2007/09/insights070905.html)

In interpreting the preambular language (chapeau) of GATT Article XX, the panel viewed that Brazil's exemption of the ban of retreaded tyres from MERCOSUR countries was not "arbitrary" since Brazil merely complied with MERCOSUR rules and that such exemption was not "unjustifiable" either since the amount of imports from those countries was insignificant.