ARTICLE XXIV OF GATT AND TAX IMPLICATIONS OF EPAs: CONTENT OF DUTIES AND OTHER REGULATIONS, IMPLICATIONS RELATED TO THE CREATION OF THE EPAs, TRADE DIVERSION, SCOPE OF POSSIBLE COMPENSATION.

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FAIR TRADING COMMISSION

Distinguished guests, Ladies and Gentlemen, Good Morning. I would like to congratulate the International Centre for Trade and Sustainable Development and Enda Tiers Monde for organizing this Dialogue on Systemic Issues related to EPAs, and to express my appreciation for their invitation to address you this morning on this topic.

Let me first confess that I am not an economist by training and will not therefore address you on the various economic models for measuring trade diversion and tax implications and what these have revealed in the context of the EPAs.

I will start with a brief background to the EPAs and thereafter address issues related Article XXIV and its treatment of regulations of commerce, some of the implications for the creation of the EPAs and the issue of compensation.

Background

The ACP-EU Partnership Agreement was signed in Cotonou in June 2000 (Cotonou Agreement) and provides for the conclusion between the ACP and the EU of WTO compatible trading

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arrangements, removing progressively barriers to trade between them and enhancing cooperation in all areas relevant to trade, (Article 36 (1)). These are called Economic Partnership Agreements (EPAs). Economic Partnership Agreements (EPAs) are defined by the Cotonou Agreement as the major instrument of economic and trade co-operation.

The EPAs were to have come into force in January 2008 after the end of the waiver by the WTO on the preferential market access of the ACP countries into the EU provided by the Cotonou agreement.

The EPAs promise considerable benefits to ACP countries in terms of deepening of the regional integration, reforms in the trade policies and potential trade and investment flows between them and the European Union. But the planned free trade agreements with the EU will also pose a number of policy, administrative, and institutional challenges for the ACP countries, including: replacing forgone tariff revenues as a result of tariff dismantling, avoiding serious trade diversion, appropriately regulating liberalized service industries and liberalizing internal trade within the ACP's regional economic groups.

Tax implications

Reduction of tariff revenues on account of tariff liberalization and adoption of the WTO customs valuation agreement focusing on transaction value is one of the likely effects of the EPAs. This loss in revenue, however, must be balanced against the expected benefits of EPAs such as economies of scale from more integrated markets, an increase in efficiency and productivity as a result of greater competition, increased opportunities for adopting technologies from the EU, and increases in domestic and foreign investments.

It may be suggested that economies can be protected form this by the introduction of non-discriminatory consumption taxes to make up for the shortfall during the interim period before full reciprocity in the relationship between ACP countries and the EU. The prospects for this, however, are problematic given the downside of EPAs that will undoubtedly affect governments' ability to increase domestic taxes or introduce new taxes. The downside would include the possibility of increased closures of 'infant' industries faced with increased competition from cheaper imports, job losses, de-industrialization in fledgling sectors due to increased demand for EU imports, and reduction in government spending for social services and development.

Trade diversion

On the question of trade diversion, this refers to the trade diverted because of the substitution from suppliers from the rest of the world to those from the EU. These suppliers from the rest of the world could have been more efficient but blocked by the existence of tariffs against their products. This is contrasted with trade creation which refers to the extra trade generated by the reduction or complete removal of the tariffs on goods imported. This means once tariffs are reduced or removed, traders will import more from the EU (as compared to other countries) since it is cheaper than before the reduction or removal of tariffs.

The binary position of trade creation and trade diversion may create the impression that trade diversion is bad and trade creation is good. Trade diversion brought about by preferential tariffs

in FTAs that substitute EU suppliers for third country suppliers is likely to lead to a reduction in prices for goods to consumers. This too would be the likely result of trade creation.

Main provisions of Article XXIV of GATT 1994 regarding RTAs

The main provisions of GATT 1994 regarding FTAs are Article XXIV: 4; Article XXIV: 5; Article XXIV: 6, and Article XXIV: 8. According to Article XXIV:4 of GATT, the general purpose of FTAs or customs unions is to facilitate trade between the constituent territories and not to raise barriers to trade with parties external to such trading arrangements. Article XXIV: 5 sets out the conditions under which an FTA can be formed. For example, Article XXIV:5 (a) stipulates that a customs union can be formed if duties or other regulations of commerce formed at the institution of the customs union are not on the whole higher or more restrictive than what existed before the formation of the customs union. Article XXIV: 5 (b) sets out the same requirement for FTAs commerce formed at the institution of the customs union are not on the whole higher or more restrictive than what existed before the formation of the customs union. Article XXIV: 5 (b) sets out the same requirement for FTAs.

Article XXIV: 6 provides for negotiated compensation under Article XXVIII of GATT in the event tariffs are to be increased above the concession rate in the formation of a customs union.

Article XXIV: 8 defines customs unions and free trade areas. A customs union is an entity in which 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 members of the union or at least with respect to substantially all the trade in products originating in such members. Customs unions also establish common tariffs and other regulations of commerce to be applied to parties external to the union.

The requirement for elimination of restrictive regulations of commerce regarding substantially all trade with members also applies to an FTA, but not the obligation for common tariffs or other regulations of commerce to be applied to third parties.

Article XXIV of GATT thus creates both an internal and external liberalization requirement. The internal liberalization requirement is ‘the restrictive regulations of commerce’ (ORRC) and the external liberalization requirement is ‘other regulations of commerce’ (ORC). In addition, Article XXIV involves an obligation not to raise external barriers, and the application of a necessity test for measures that would otherwise breach core obligations such as MFN.

Content of ‘other restrictive regulations of commerce’

Article XXIV of GATT does not define ‘other restrictive regulations of commerce’ nor does the interpretive note to Article XXIV. A comparison of the term ‘other restrictive regulations of commerce’ with ‘other regulations of commerce’ (the external liberalization requirement) suggests that the latter involves a broader category of regulations.

However, restrictive regulations of commerce would at the very least include WTO inconsistent measures in existence before the formation of the customs union or free trade area and for which no specific waiver has been obtained for their maintenance. The term would also include WTO inconsistent measures introduced after the formation of the customs union or FTA.

This interpretation is supported by the text of Article XXIV: 8. A WTO inconsistent measure or regulation for the purposes of Article XXIV:8 would include measures under Articles XI, XII, XIV, XV and XX of GATT 1994 that are unnecessary from the standpoint of the *Turkey-Textiles* standard. That is, these measures or regulations can be deemed restrictive if they are not necessary for the formation of the customs union or are not introduced upon the formation of the customs union or FTA.

With respect to measures or regulations justifiable under GATT Article XX, it is unclear whether two separate tests would have to be met for such measures or regulations to avoid the designation of 'restrictive regulations of commerce', the two tests being GATT Article XX inclusive of the Chapeau and the necessity test articulated in *Turkey-Textiles*. For example, although GATT Article XX and GATT Article XXIV contain a necessity test regarding the legality of maintaining GATT inconsistent measures, the tests contain different standards. Consequently, a measure necessary under Article XX need not be necessary under GATT Article XXIV. Additionally, satisfaction of the necessity test under Article XX of GATT is insufficient for a measure or regulation to be justified under GATT Article XX since the text of the Chapeau thereto must be taken into account.

The Appellate Body has stated that consistent with the principles of interpretation it is bound to follow under Article 3.2 of the Understanding and Rules on Procedures Governing the Settlement of Disputes (DSU) all covered agreements under the WTO must be given effect. It has gone further in recognizing that all provisions in a treaty must be given effect according to the principle of effective interpretation. Thus, it has held in ***US-Reformulated Gasoline*** that '*One of the corollaries of the "general rule' of interpretation" in the Vienna Convention is that interpretation must be given meaning and effect to all terms of a treaty. A treaty interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility'*.[1]

Applying the principle of effective interpretation would suggest that both Article XX and XXIV should be given effect unless one provision is an exception to the other or constitute an exemption from general obligations included in the other. In some situations, for example in the case of sanitary and phyto- sanitary measures or technical barriers to trade under the SPS and TBT agreements, satisfaction of the Article XX provision would arguably suffice for the measure or regulation to avoid being designated a 'restrictive regulation of commerce', assuming that the specific provisions of those agreements are met with respect to the measures or regulations put in place.[2] In any event, satisfying the provisions of those specific agreements would make irrelevant a defence under Article XX of GATT.

[1] *United States-Standards For Reformulated and Conventional Gasoline*, (1996) WT/DS2/AB/Rt, at section IV.

[2] The possibility of the legality of SPS measures being considered under the SPS Agreement and GATT Article XX (b) is not inconceivable given that a measure may be inconsistent with the SPS Agreement but may be justified under GATT Article XX. Secondly, the preamble to the SPS Agreement contemplates the consideration of SPS

This interpretation would also govern measures or regulations under the other provisions mentioned under the exemption in Article XXIV. Whether or not regulations or measures under other Articles of GATT not mentioned in the exempting clause of Article XXIV would also be implicated in this analysis is subject to debate, although it is widely argued that the exemptions mentioned in Article XXIV are not exhaustive and may in fact include other provisions such as Article XXI of GATT 1994.

Content of duties and other regulations of commerce

GATT Article XXIV provides that other restrictive regulations of commerce as between RTA members must be eliminated and that other regulations of commerce must not on the whole be higher or more restrictive than what existed before the formation of the customs union or FTA. As with 'other restrictive regulations of commerce', the specific content of other restrictive regulations of commerce (ORRC) and other regulations of commerce (ORC) is not defined in Article XXIV or the Interpretive Note to Article XXIV. As noted above, the term other regulations of commerce suggests a wider category of regulations than restrictive regulations. This interpretation is supported by the jurisprudence of the WTO, in particular the *Turkey-Textiles* decision.

Meaning of '*other regulations of commerce*'

In *Turkey-Textiles* the Panel stated:

> 'While there is no general 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 phyto-sanitary, customs valuation, antidumping, technical barriers to trade; as well as 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'.[3]

Implications for the creation of EPAs

The main implications for the creation of EPAs are contained in the obligations for FTAs in Article XXIV with respect to the internal and external liberalization requirements. For the internal liberalization requirement, there is the obligation that ORRCs should be eliminated with respect to substantially all trade.

Meaning of '*substantially all*'

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measures or regulations under the rubric of Article XX and the SPS Agreement as is states that the SPS Agreement is '…to elaborate rules for the application of the provisions of GATT 1994 which relate to the use of sanitary and phytosanitary measures, in particular the provisions of Article XX (b).

[3] *Turkey-Textiles*, Panel Report, para. 9.120.

The meaning of 'substantially all' trade is not settled. At issue is whether a quantitative standard is to be used or a quantitative and qualitative standard. Use of a quantitative standard permits an interpretation that 'substantially all' is achieved when most sectors are covered.

Without exhausting the options of interpretation in this regard, we may note three possible scenarios. First, there is a quantitative liberalization of *all sectors for most of the trade* in each sector, with the benchmark figure being at least 90 per cent for example to represent 'substantially all'. Second, there is a quantitative liberalization of *most sectors for all of the trade* in the individual sectors. This interpretation permits exclusion of a sector irrespective of the proportion of trade with the parties in relation to other sectors, provided that there is total liberalization of trade for the remaining sectors.[4] Alternatively, and what is probably more acceptable, is that a sector can be excluded if it represents a very small proportion of the trade between the parties, with an agreed upon benchmark figure to represent the small proportion of trade that operates as a *de minimis* threshold. Third, there is liberalization of trade *for all sectors with the possibility of excluding some products within a particular sector* or sectors. Fourth, there could be a combination of the scenarios envisaged in the three options discussed above. For example, all sectors could be liberalized under option one with the exclusion of some products from particular sectors under option three.

On the other hand, if the quantitative and qualitative standard are used, exclusion of any sector irrespective of trade coverage for the parties would arguably not satisfy the 'substantially all' trade requirement for Article XXIV. This interpretation is seemingly supported by the Preamble Understanding on the Interpretation of GATT Article XXIV. However, Working Parties for specific FTAs have not established a position that has found wholesale acceptance on this issue. A Working Party examining the EEC-Finland Free Trade Agreement in 1973 interpreted 'substantially all' to mean the liberalization of all products and without the exemption of any particular sector of the economy irrespective of its trade coverage with the parties.[5] By contrast, a Working Party examining the United States-Canada Free Trade Agreement did not adopt the 'all products' liberalization interpretation, but provided a positive appraisal despite the fact that some agricultural products (not the sector as a whole) such as fresh fruits, vegetables, corn and corn products, eggs, and milk products were exempted.[6]

However, the use of the term 'substantially all' trade as opposed to 'all' trade suggests some flexibility in the application of the concept of 'substantially all'. There is no established legally binding custom with respect to FTAs in general or any binding interpretation for the term. Although a precise definition is warranted especially to stave off possible claims of a breach of the obligations in Article XXIV and the attendant implications for compensation, it is perhaps

[4] This interpretation is, however, at variance with the Preamble of the Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade. For example, the third and fourth paragraphs of the Preamble states: '*Recognizing* the contribution to the expansion of world trade that may be made by closer integration between the economies of the parties to such agreements;
Recognizing also that such contribution is increased if the elimination between the constituent territories of such duties and other restrictive regulations of commerce **extends to all trade**, and **diminished if any major sector of trade is excluded**'. Bold emphasis mine.
[5] BISD, 21S/79.
[6] BISD, 38S/73.

unlikely, though not impossible[7], for such claims to be raised, particularly because countries external to the FTA would presumably prefer discrimination regarding *less than substantially all trade*.

Meaning of '*shall not on the whole be higher or more restrictive than what existed before*'

By contrast the external liberalization requirement of Article XXIV provides that duties and other regulations of commerce shall not on the whole be higher or more restrictive than what existed before. The Understanding on the Interpretation of GATT XXIV provides some guidance for interpretation and application of this term with respect to duties, that is the weighted average tariff rates and duties collected for a representative period.[8] For other regulations no guidance is provided, the Understanding merely noting that:

'…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]

The use of the word 'higher' seem to refer to duties while the term 'more restrictive' refers to regulations other than duties, if one accepts the view that regulations cannot grammatically or practically be higher. If this view is correct, the use of the term 'more restrictive' in Article XXIV:5 (a) and (b) suggests that restrictive regulations are permissible, but that they should not be more restrictive than what existed before the formation of the customs union or FTA, although the appropriate benchmark for that evaluation is not settled.

At the very least, one could suggest that regulations that are WTO compatible are not restrictive. This would include regulations or measures that are justifiable under GATT Article XX, for example, or those regarded as necessary under Article XXIV despite their violation of core obligations such as MFN and national treatment. It may also include some non-tariff measures that are not designed to reduce market access but for overarching principles of health protection or protection of the environment. Additionally, a restrictive regulation or trade measure may be permissible if it is employed as the least restrictive measure to obtain the objective of the members of the FTA.

Implications regarding dumping, subsidies and safeguards

One of the main areas of debate is whether the laws regarding dumping, subsidies and safeguards (trade remedies) are 'restrictive regulations of commerce' to be eliminated for substantially all trade in accordance with Article XXIV:8 (a)(i) and (b) of GATT or can be categorized as 'other regulations of commerce' under Article XXIV:5 and, therefore, to satisfy the obligation that regulations or measures thereunder should not be more restrictive than what obtained before the formation of the FTA.

[7] For example, an argument can be raised by third parties in dispute settlement proceedings that the internal liberalization requirement is not satisfied where Article XXIV is invoked as a defence to a claim of a breach of a WTO obligation.
[8] See Article XXIV: 5(2) of the Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994.
[9] Ibid.

The exclusion of GATT Article VI and GATT Article XIX from the list of exempting provisions in Article XXIV pursuant to which certain measures can be maintained if necessary tends to the view that there is an obligation under Article XXIV: 8 for members of a customs union or FTA to refrain from applying trade remedy measures against each other. As discussed above, however, the rationale for discerning this obligation is not very convincing since the exempting Articles in Article XXIV to cover necessary measures cannot necessarily be seen as exhaustive of the measures that can be included even though they may run afoul of core obligations.

That the exempting Articles are not exhaustive can be seen from the fact that important Articles such as the security exception in Article XXI and the balance of payments restrictions for developing countries in Article XVIII.B, are not specifically exempted, even though it is doubtful that is intended. As a matter of interpretation then, it may be more accurate to suggest that trade remedy measures are not excluded from the exempt list since they have not been specifically barred from this seemingly non-exhaustive list. This interpretation is supportable by the *Lotus* principle to the effect that sovereignty requires that that which is not strictly prohibited to states is permitted to them,[10] but also by such supplementary principles of interpretation as *in dubio mitius*, according to which a tribunal interpreting an ambiguous provision is directed to choose the meaning that is less onerous on the party assuming the obligation.

If one takes the view that restrictive regulations of commerce refer to at least WTO inconsistent measures, then trade remedy measures may not be deemed restrictive to the extent they are WTO consistent. This argument can be supported by the fact that all measures that affect trade flows in some way are in a sense restrictive of trade but are not necessarily trade restrictive and therefore to be eliminated on substantially all trade. In the case of phtyo-sanitary measures, for example, these represent non-tariff barriers to trade that serve a legitimate objective of health protection, but are not regarded as restrictive regulations of commerce to be eliminated.

On this view, trade remedy measures would not be restrictive regulations of commerce *per se*; they become so if they violate WTO provisions. There is of-course the view that trade remedy measures can be applied by FTA members in a manner that violates the requirement that other restrictive regulations of commerce must be eliminated regarding substantially all trade.[11] This could occur in a situation whereby several FTA partners simultaneously maintain trade remedy measures, a situation all the more likely where any one of the RTA partners decides to use such remedies as a trade policy to assuage domestic interests and others follow suit.[12]

This means that while trade remedies are not excluded within an FTA they cannot be so applied as to derogate from the substantially all trade liberalization requirement. The remaining is to determine when this threshold has been met after the application of a trade remedy measure. The application of safeguard measures within an FTA arguably carries a greater risk for breach of this obligation, even if the measure is applied on a product specific basis, since such measures

[10] *S.S. Lotus (France v. Turkey*), 1927, P.C.I.J. Reports, Series A, No. 10, at p. 18-19.
[11] See, for example, Delroy S. Beckford, 'Trade Remedies Within the Caricom Single Market and Economy: Some Thoughts on the Challenge for Achieving a Coherent Administration', *West Indian Law Journal*, vol. 32, no.1. May 2007.
[12] Ibid, p. 48.

are to be applied on an MFN basis within the FTA. By contrast, antidumping and countervailing duty measures would be less trade restricting because they would be applied on a product specific non-MFN basis.[13]

Whatever the view taken on this issue, disputes brought before the WTO establish that the substantive provisions of the trade remedy agreements (at least in the case of safeguards) are to be observed irrespective of whether an FTA excludes the provision from application within the FTA. Disputes brought before the WTO also indicate that the substantive provisions of the trade remedy agreements are to be observed irrespective of whether an FTA excludes the provision from application within the FTA. Arguing that its safeguard measure against non-MERCOSUR countries could not be applied against MERCOSUR Members because of the provisions of MERCOSUR, Argentina in *Argentina-Footwear*[14] maintained in its defence the consistency of its measure under Article 2 of the SGA, and that the selective application of the measure can be done where it is carried out by a customs union.

The Appellate Body rejected the argument, clarifying that if the finding of an increase in imports is based on imports from MERSOSUR Members, the measure must be applied against them as well. This left open the question of whether the measure would still have to be applied against MERCOSUR Members if their imports were excluded from the finding regarding an increase in imports. This issue did not arise in the dispute, and no clarification was sought or given on it.

The Appellate Body, however, did not treat the selective application issue as arising under footnote 1 of Article 2 of the SGA (relating to measures adopted by a customs union) because the measure in issue was not applied on behalf of the customs union as a whole, but by a member of the union for its own benefit.

In the case of subsidies, it is worthy of note that the maintenance of agricultural subsidies by FTA Members is now subject to challenge under the Agreement on Subsidies and Countervailing Measures (SCM).

Prior to the US-*Subsidies on Upland Cotton*[15] decision, the SCM Agreement was treated as subject to the Agreement on Agriculture. Thus, export subsidies, generally proscribed under the SCM Agreement, were considered shielded from challenge for agricultural products to the extent that those export subsidies were included in the subsidizing WTO Member's schedule. Two developments question this reading of the relationship: first, the expiry of the 'peace clause'(Article 13 of the Agreement on Agriculture) on January 1, 2004,and, second, the Appellate Body's decisions in *EC-Bananas III*[16], and *Chile Price Band System*, that signaled the interpretive approach it would adopt in the *Upland Cotton* decision.

In *EC-Bananas III*, and *Chile Price Band System*[17], the Appellate Body had occasion to interpret Article 21 of the Agreement on Agriculture, specifically the relationship between Article 21 and

[13] Ibid, p. 47.
[14] WT/DS98/AB/R, adopted January 12, 2000.
[15] WT/DS267/AB/R, adopted March 21, 2005.
[16] WT/DS27/AB/R, adopted September 25, 1997, para. 155.
[17] WT/DS207/AB/R, adopted October 23, 2002, para. 186.

the Annex IA Multilateral Agreements of GATT 1994. Article 21 of the Agreement on Agriculture provides for the application of the GATT 1994 Annex 1A Multilateral Agreements "subject to the provisions of this Agreement". This provision was interpreted to mean "except to the extent that the Agreement on Agriculture contains specific provisions dealing specifically with the same subject matter".

The term 'same subject matter' was then applied in the context of the relationship between the Agreement on Agriculture and the SCM Agreement to mean that, as regards prohibited subsidies, the specific provision invoked in the Agreement on Agriculture as an exception to the SCM Agreement must specifically refer to prohibited subsides. In the *US-Subsidies on Upland Cotton* decision, none of the provisions of the Agreement on Agriculture advanced by the United States, to justify their subsidies, mentioned prohibited subsidies specifically.

The current position, as the Appellate Body clarified in *US-Subsidies on Upland Cotton*, is that prohibited subsidies under SCM Agreement Article 3.1(a) and 3.1 (b) are not shielded from challenge, despite the introductory language of Article 3.1 of the SCM Agreement "except as provided in the Agreement on Agriculture." That the expiry of the 'peace clause' did not influence this holding suggests that prohibited subsidies are now inconsistent with the Agreement on Agriculture. In short, prohibited subsidies on agricultural products are subject to the discipline of the SCM Agreement.

'Other restrictive regulations of commerce', 'other regulations of commerce' and GATT Article 1 and EPAS MFN clause

An important question for the implications of Article XXIV obligations for EPAs (and for the question of possible compensation as well) is the extent to which the internal and external liberalization requirement must satisfy the MFN obligation with regard to third parties.

The jurisprudence from the WTO has not resolved the issue of whether benefits granted by RTA members to each other with respect to their 'other restrictive regulations of commerce' (ORRCs) or the internal liberalization requirement should in general be extended to WTO Members that are external to the RTA in question. And, there is still some uncertainty lingering on the relationship between Article 1 of GATT 1994 and the external liberalization requirement that 'other regulations of commerce' (ORCs) must not on the whole be higher than what existed before the formation of the RTA. For example, to the extent that an SPS measure may be classified under 'other regulations of commerce', a mutual recognition agreement under the SPS Agreement may violate MFN if not extended to all WTO Members although it may be impractical to extend the benefits of such an agreement to all WTO Members if their SPS measures do not meet a WTO Member's desired level of health protection.

Relationship between the enabling clause and Article XXIV of GATT 1994

This raises the question of the particular relationship between the Enabling Clause and Article XXIV of GATT 1994. There is yet no definitive ruling on this relationship but some tentative general observations may be made from the *EC-Tariff Preferences*[18] case and the general

[18] *European Communities-Conditions for the Granting of Tariff Preferences to Developing Countries*, WT/DS/246/AB/R.

interpretive principles applied in resolving seemingly conflicting provisions in the WTO Agreement.

In *E-C Tariff Preferences*, the Appellate Body held that developed countries have the right to extend special and differential treatment to developing country beneficiaries under a GSP scheme but that similarly situated beneficiaries must not be subject to discriminatory treatment. A GSP scheme is usually operated under the Enabling Clause and the Enabling Clause is an exception to MFN. However, *EC-Tariff Preferences* has clarified that the exception to MFN in the operation of a GSP scheme is not absolute. Rather, the MFN provision is to be respected with regard to similarly situated beneficiaries.

An important aspect of the Enabling Clause is that it seemingly permits developing countries to form RTAsF6A without the need to observe the requirements of MFN.

A significant interpretive question is whether the MFN provision must be observed for FTAs formed among developing countries pursuant to the Enabling Clause to be consistent with Article XXIV of GATT 1994. A related question is whether the MFN provision, if it is excluded under the Enabling Clause for FTAs with developing countries, is also excluded for FTAs between developed and developing countries.

Paragraph 3(a) of the Enabling Clause provides the rudiments of an answer. Paragraph 3 (a) states that "[any differential and more favourable treatment provided under this clause] shall be designed to facilitate and promote the trade of developing countries and not to raise barriers to or create undue difficulties for the trade of any other contracting parties; . . ."

This language appears to establish a legal condition for the operation of the MFN exception in the Enabling Clause. The use of the term 'contracting parties' in reference to the obligation for the special and differential treatment to not raise barriers to trade is not limited to the trade of developing countries. The trade of all WTO Members is therefore implicated in this obligation. The MFN override in the enabling Clause is therefore not absolute but is dependent on whether or not its operation can be characterized as raising barriers or creating undue difficulties for the trade of other contracting parties, whether developed or developing. Provided this obligation is met, it seems therefore that MFN need not be observed for FTAs with developing countries in so far as the external liberalization requirement is concerned.

Under what circumstances are barriers to be considered raised in the operation of differential and more favourable treatment? In the context of FTAs formed pursuant to Article XXIV of GATT 1994, this may arise whereby duties and other regulations of commerce are on the whole higher than what existed before the formation of the RTA.

If this reading is correct, the Enabling Clause would not exempt the application of Article XXIV and its requirement with respect to the external liberalization requirement regarding other regulations of commerce as they apply to parties external to an RTA with developing countries, or even an RTA between developed and developing countries.

Would exclusion EPA's MFN clause exclude MFN treatment for third parties?

Another implication for EPAs worth noting (and for scope of possible compensation to third parties) is whether exclusion of the EPA MFN clause removes the obligation to honour the MFN obligation in any event.

It is arguable that the controversial MFN provision in EPA may be desirable as a political compromise issue, but the legal effect of the removal would not necessarily translate into the contemplated polar position, that is, that benefits given to third parties need not be extended to the EU. The EU, for example, may be party to EPA but a third party in respect of some other FTA in which some EPA members have formed and FTA.

Except under specific agreements in which some variable geometry is permissible (e.g. GATS), or there is a permanent MFN override exemption as in the Enabling Clause, or some other MFN exemption in the WTO annexed agreements, the MFN obligation constitutes a core obligation within the single package arrangement at the multilateral level. Benefits extended must be extended immediately and unconditionally to other WTO Members. An MFN clause in EPA therefore is one that articulates an obligation that is already established to apply without the need for its express inclusion in the agreement.

What is unclear from EPA's MFN provision however is whether the reference to 'benefits' are those classifiable as restrictive regulations of commerce as opposed to other regulations of commerce. If the reference to 'benefits' includes the former, in the sense of tariff concessions granted to third countries as part of a post-EPA CARIFORUM-other parties RTA, this would go beyond WTO obligations. This is because the MFN obligation as regards the removal of restrictive regulations of commerce need only be respected as between RTA parties for that internal liberalization requirement under Article XXIV of GATT 1994. This interpretation is consistent with the application of the principle of effective interpretation that would safeguard the rights of parties to enter into preferential trading arrangements under Article XXIV of GATT.

It bears repeating then that the MFN obligation when applied to several FTAs in which the parties in one RTA are simultaneously members of another or several other FTAs, does not require adherence to the MFN obligation with respect to 'other restrictive regulations of commerce' as regards the relationship between parties to the RTA and third parties.

On this view, an MFN provision in any FTA between developed and developing countries would not prevent the subsequent formation of an FTA between developing countries under the Enabling Clause.

Scope of possible compensation

The scope of possible compensation for third parties to an FTA would typically arise from breach of a WTO obligation of the exercise of rights within the RTA. The breach of a WTO obligation could also arise in respect of the breach of an FTA obligation where, for example, the content of the rule in both legal regimes is similar. In either case, the possible compensation to third parties depends on whether a WTO obligation is at issue, but also whether bilateral obligations are affected and the particular fora chosen under those regimes for the resolution of disputes.

Compensation to third parties can arise in the context of the WTO dispute settlement system for breach of a WTO obligation. A convenient starting point for this analysis is the core obligations of national treatment and most favoured nation treatment.

GATT Article III: 1-4, provide as follows:

*1. The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.**

*2. The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.**

3. With respect to any existing internal tax which is inconsistent with the provisions of paragraph 2, but which is specifically authorized under a trade agreement, in force on April 10, 1947, in which the import duty on the taxed product is bound against increase, the contracting party imposing the tax shall be free to postpone the application of the provisions of paragraph 2 to such tax until such time as it can obtain release from the obligations of such trade agreement in order to permit the increase of such duty to the extent necessary to compensate for the elimination of the protective element of the tax.

4. The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product.

By contrast GATT Article I relating to the MFN obligation provides as follows:

With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III, any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.

As discussed above, Article XXIV of GATT stipulates that exceptions to these core principles are permissible if necessary.

Compensation and unilateral action

Forced compensation or retaliatory measures occasioned by unilateral action are other considerations to be borne in mind in respect of a breach of a WTO or other obligation owed to third parties. In this situation, there is no payment of money damages to an aggrieved party taking unilateral action, but the nature and scope of the unilateral action generates costs that amount to the transfer of resources from the country maintaining the measure and the country retaliating. The transfer of resources takes place in the sense of the difference in the value of trade affected as a result of the retaliatory action and the value of the trade that would have taken place without the retaliatory action.

Consider, for example, the claim of the EC in the dispute concerning the 1916 Antidumping Act of the US that the remedies provided for dumping under that legislation resulted in a chilling effect to trade between the EC and the US as EC producers reduced the level of manufactured goods entering the US market for fear of being prosecuted.

In this respect the scope of the compensation could be measured in terms of the benefit foregone as a result of the withdrawal of an offending measure. Alternatively, compensation could be measured in terms of the difference between the benefit of maintaining the measure and the cost of the retaliatory action.

Here, it may be appropriate to distinguish between withdrawal of a measure brought about by a binding ruling and one that amounts to a premature withdrawal, that is, the withdrawal of a measure not compelled by a binding ruling. This distinction is made on the basis that within the WTO dispute settlement system, at any rate, a challenged measure may remain in place as long as the reasonable period for compliance with a WTO ruling has not expired.

In the former case, (i.e. withdrawal of a measure resulting from a binding ruling) the perceived benefit to be had in the maintenance of the challenged measure is possibly far greater than in the latter case where withdrawal takes place as soon as opposition is mounted and consultations are requested to resolve the dispute.[19]

Determining the possible compensation payable therefore depends on the particular costs of maintaining an offending measure when retaliatory action has been taken.

Legality of unilateral action under WTO Law

Although unilateral action to correct breach of a WTO obligation is forbidden in accordance with DSU Article 23[20], there are circumstances in which such unilateral action can be taken. In the

[19] The understanding of the term 'benefit' may differ depending on whether the goal is to promote regional trade and the challenged measure is geared to that objective. Alternatively, 'benefit' may be understood in terms of the promotion of liberalized trade independent of the benefits that may accrue to a regional trading arrangement. In the latter case, the extent of trade diversion resulting from a measure designed to promote a regional trading arrangement may include unspecified costs to the RTA trading partners.

[20] DSU Article 23 provides as follows:

case of *United States- Sections 301-310 of the Trade Act of 1974*[21], the panel held that though the legislation was contrary to Article 23 of the DSU it could not be challenged as such because it permitted the executive to exercise its discretion as to whether the application of the legislation would breach WTO law. In this case, the panel explored the distinction between mandatory and discretionary legislation, the former mandating a breach of WTO law and can be challenged as such, the latter reposing a discretion in the executive as to whether the application of the law will breach WTO rules, and can only be challenged when applied.

This distinction between mandatory and discretionary legislation permits some leeway for the application of laws that are not necessarily facially violative of WTO rules, but which can afford the WTO member applying such laws room to apply retaliatory measures until a WTO ruling determines the measure to be in violation of WTO rules. This scenario has implications for compensation to third parties in the sense of the transfer of resources takes being the difference in the value of trade affected as a result of the retaliatory action and the value of the trade that would have taken place without the retaliatory action.

Compensation for breach of specific obligations

Despite the general standard for compensation set out in Article 22.4 of the DSU, specific agreements provide standards for compensation that are at variance with this general standard. Thus, in the case of prohibited subsidies, the standard is that there should be 'appropriate countermeasures' in accordance with Article 4.10 of the Agreement on Subsidies and Countervailing Measures (SCM). This standard has been applied to mean the total amount of the

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1. When Members seek the redress of a violation of obligations or other nullification or impairment of benefits under the covered agreements or an impediment to the attainment of any objective of the covered agreements, they shall have recourse to, and abide by, the rules and procedures of this Understanding.

2. In such cases, Members shall:

   (a) not make a determination to the effect that a violation has occurred, that benefits have been nullified or impaired or that the attainment of any objective of the covered agreements has been impeded, except through recourse to dispute settlement in accordance with the rules and procedures of this Understanding, and shall make any such determination consistent with the findings contained in the panel or Appellate Body report adopted by the DSB or an arbitration award rendered under this Understanding;

   (b) follow the procedures set forth in Article 21 to determine the reasonable period of time for the Member concerned to implement the recommendations and rulings; and

   (c) follow the procedures set forth in Article 22 to determine the level of suspension of concessions or other obligations and obtain DSB authorization in accordance with those procedures before suspending concessions or other obligations under the covered agreements in response to the failure of the Member concerned to implement the recommendations and rulings within that reasonable period of time.

[21] *United States-Sections 301-310 of the Trade Act of 1974*, WT/DS152/R, December, 22, 1999.

subsidy granted.[22] The justification for this approach seems to be based on the fact that such subsidies are to be withdrawn without delay in accordance with Article 4.7 of the SCM Agreement.[23]

Disputes related to breach of the Agreement on Subsidies and Countervailing Measures (SCM) seem to be the only set of disputes for which a special standard is articulated as distinct from the general standard of remedying nullification and impairment with an equivalent level of suspension of concessions or compensation.

Another possible exception is contained in Article 8 of the Agreement on Safeguards which permits WTO Members to suspend the application of 'substantially equivalent concessions and other obligations' in response to safeguard measures. Under Article 8 of the Agreement on Safeguards, disputes on whether concessions suspended are 'substantially equivalent' may be referred to the Ministerial Conference or General Council but not to the panel or Appellate Body.

Although the standard is similar to the general standard for compensation or authorized retaliation, the possibility of variance therefrom in its application exists because there is no requirement that the suspension of concessions take place after a reasonable period of time for compliance with an obligation has expired. Moreover, this issue can be addressed only after the suspension of concessions has taken place.

In other words, the suspension of concessions does not depend on whether there is a breach of the Agreement on Safeguards. Rather, it is when the concession may be sought that depends on whether there is a breach of the Agreement on Safeguards.[24] More importantly, the suspension of concessions can apply to the period when the safeguard measure was first imposed thereby providing for a type of retroactive remedy.

Notwithstanding the above, compensation for breach of obligations would, in the main, have to satisfy the general standard articulated in DSU Article 22.4.

Scope of compensation in the WTO Dispute Settlement System

Compensation under the WTO dispute settlement system is based on an MFN basis. Breach of a WTO obligation, therefore, requires that the compensating party offers a compensation package to other WTO Members. By contrast, authorized retaliation takes place after a reasonable period of time for compliance with a WTO ruling has expired and is bilateral in nature. That is, the authorized retaliation is against the offending party and is not carried out on a collective basis.

[22] *Brazil-Aircraft (Article 22.6)*, paras. 3.60, 3.66; *US-FSC (Article 22.6)*, paras. 5.37-40; *Canada-Aircraft Credit and Guarantees (Article 22.6)*, paras.3.10, 3.13.
[23] *Brazil-Aircraft (Article 22.6)*, paras. 3.45; *US-FSC (Article 22.6)*, paras. 6.10-32; *Canada-Aircraft Credit and Guarantees (Article 22.6)*, para.3.60.

[24] See, for example, Article 8.3 of the Agreement on Safeguards which provides as follows: 'The right of suspension referred to in paragraph 2 shall not be exercised for the first three years that a safeguard measure is in effect, provided that the safeguard measure has been taken as a result of an absolute increase in imports and that such a measure conforms to the provisions of this Agreement'.

In most cases, the breaching party can continue with the violation until a reasonable period of time for compliance occurs. When this strategy is pursued, an offending party can bypass the compensation provision and await a compliance panel ruling before withdrawal of its measure to preempt authorized retaliation. This is facilitated by the text of Article 22 of the DSU which provides as follows:

1. Compensation and the suspension of concessions or other obligations are temporary measures available in the event that the recommendations and rulings are not implemented within a reasonable period of time. However, neither compensation nor the suspension of concessions or other obligations is preferred to full implementation of a recommendation to bring a measure into conformity with the covered agreements. Compensation is voluntary and, if granted, shall be consistent with the covered agreements.

2. If the Member concerned fails to bring the measure found to be inconsistent with a covered agreement into compliance therewith or otherwise comply with the recommendations and rulings within the reasonable period of time determined pursuant to paragraph 3 of Article 21, such Member shall, if so requested, and no later than the expiry of the reasonable period of time, enter into negotiations with any party having invoked the dispute settlement procedures, with a view to developing mutually acceptable compensation. If no satisfactory compensation has been agreed within 20 days after the date of expiry of the reasonable period of time, any party having invoked the dispute settlement procedures may request authorization from the DSB to suspend the application to the Member concerned of concessions or other obligations under the covered agreements.

Since the purpose of Article 22 is to secure compliance (i.e. the withdrawal of the offending measure) this may explain the preference for prospective remedy whereby authorized retaliation is limited to the level of nullification and impairment suffered after a reasonable period of time for compliance with a WTO ruling has occurred. The prospective remedy approach also finds support in Article 19 of the DSU which provides as follows:

Where a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned[25] *bring the measure into conformity with that agreement.*[26] *In addition to its recommendations, the panel or Appellate Body may suggest ways in which the Member concerned could implement the recommendations.*[27]

The prospective remedy approach, for example, has been applied in *EC-Bananas III (Ecuador) (Article 22.6 EC)*[28], and also *Brazil-Aircraft (Article 22.6 -Brazil*).[29]

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[25] The "Member concerned" is the party to the dispute to which the panel or Appellate Body recommendations are directed.

[26] With respect to recommendations in cases not involving a violation of GATT 1994 or any other covered agreement, see Article 26.

[27] Article 19, *Understanding on the Rules and Procedures Governing the Settlement of Disputes*.

[28] *Decision by the Arbitrator, European Communities-Regime for the Importation, Sale and Distribution of Bananas, Recourse to Article 22.6 of the DSU by the European Communities*, DS27/ARB, March 24, 2000.

In the case of *Australia-Automotive Leather II*, however, the panel adopted a different view noting that:

"…we do not believe that Article 19(1) of the DSU, even in conjunction with Article 3(7) of the DSU, requires the limitation of the specific remedy provided for in Article 4(7) of the SCM Agreement to purely prospective action".[30]

The balance of authority, however, seems to favour the prospective remedy approach. This has obvious implications for compensation with respect to measures that are WTO inconsistent but run their course or are withdrawn before the exhaustion DSU proceedings.[31]

Compensation for breach of bilateral obligations

The nature and extent of compensation to third parties would also be affected by bilateral treaty obligations between RTA members and third parties and the particular forum chosen for the resolution of disputes. The scope of this paper does not permit any exhaustive consideration of this issue. In the case of bilateral investment treaties, for example, breach of the national treatment obligation would entail a different, and not necessarily consistent, remedy as opposed to breach of the national treatment obligation under the Agreement on Trade Related Investment Measures (TRIMS) where the WTO dispute settlement system is pursued. This is because of the existence of various tribunals where such disputes can be resolved without the requirement to follow each other's precedents, the most notable being the International Centre for Settlement of Investment Disputes (ICSID). Second, the national treatment obligation in BITS is often not identical or similar amongst them or similar to the national treatment obligation in GATT 1994. Third, the level of compensation for breach of the national treatment obligation in BITS depends primarily on the loss suffered by a particular investor whereas compensation for breach of the national treatment obligation in GATT 1994 does not depend on loss suffered, but may exist on the basis of a legislation being facially discriminatory without any trade effect.

Article XXIV as a defense

The scope of possible compensation also depends on the extent to which Article XXIV may be used as a defense to a claim of a breach of WTO obligations. In *Turkey-Textiles*, the Appellate Body noted that Article XXIV can be invoked as a defense if the conditions for formation of the FTA or customs union are and the measure or regulation for which cover is sought would have to be necessary for the customs union. In other words, compliance with the WTO obligation would prevent the formation of the customs union.[32]

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[29] *Decision by the Arbitrators, Brazil-Export Financing Programme for Aircraft-Recourse to Arbitration by Brazil under Article 22.6 of the DSU and Article 11.4 of the SCM Agreement*, WT/DS46/ARB, August 28, 2000.

[30] *Australia-Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/RW, January 21, 2000.

[31] An example of this situation is the complaint by Pakistan against the United States regarding a safeguard measure imposed under the Agreement on Textiles and Clothing. Three years had passed between the imposition of the measure and the end of the DSU proceedings. The measure was in place for three years as had been provided for and the recommendation for withdrawal of the measure took place when the safeguard measure no longer applied. See Minutes of the Meeting of the Dispute Settlement Body held on 5 November 2001, WT/DSB/M112, paras. 21-22.

[32] *Turkey-Restrictions on Imports of Textiles and Clothing Products*, WT/DS33/AB/R, (*Turkey-Textiles)*, para. 58.

Concluding remarks

The EPAs present both opportunities for meeting development objectives and challenges for making the necessary adjustments involved in a reciprocal relationship. As FTA arrangements it is critical to understand the ramifications of Article XXIV of GATT 1994 to determine how these trade arrangements will work in practice and the trade policy options to be engaged to ensure WTO compatibility of legislation and trade measures to give effect to the requirement of the EPAs, while at the same time avoiding costly compensatory schemes to third parties.

Challenges remain in the scope of the application of trade remedies and the nature of EPAs MFN clause. It is hoped that the above discussion has facilitated some basis for an informed process of further dialogue as we embark on our collective development challenges.