5 GATT’s influence on regional arrangements

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The World Bank, the International Monetary Fund (IMF), the Organisation for Economic Cooperation and Development (OECD), the General Agreement on Tariffs and Trade (GATT) – they are all in the same business. They try to influence, and sometimes do influence, national choices of policy. But no international organisation has sovereignty over any nation’s policy. In the end, a nation’s tariff or its import licensing requirement is what that country’s government says it is.

Though regional arrangements are coming into fashion (perhaps more rapidly than into function), the GATT will remain the major global steward of commercial policy. Knowing how the GATT has nuded regional arrangements toward good international (multilateral) citizenship in the past is important in judging how it might continue to do so in the future.

But if we ask ‘What are the GATT rules about regional arrangements?’ we are asking at best only half the question. Equally (or more) important is how the GATT attempts to influence a national government to keep its trade policies in line with the objectives the GATT was created to advance – fewer and less discriminatory trade restrictions.

Section 1 looks at the historical origins of GATT’s rules for regional arrangements and then at their substantive content. Sections 2–4 review GATT’s experiences with regional arrangements. Section 5 presents some conclusions and policy applications. The key to understanding the lessons these experiences provide is to remember that GATT began as an exchange of market access concessions. Preserving and extending the value of that market access is still the motivating interest for GATT’s member countries. The formation of free-trade areas (FTAs) and customs unions (CUs) among the industrialised countries – particularly the European Common Market – significantly compromised the market access of the countries left outside. GATT’s rules told outside countries that they must accept the loss of access to markets in EEC member-states that the formation of the European Economic Community would cause, but they were unwilling to do so. But in the end, the outcome was a positive one. GATT procedures for channelling trade conflicts into consultations and negotiations prevented a negative reaction by outside countries, and led eventually to the Common Market agreeing to significant reductions of its external restrictions.

The major lesson for policy is that preserving and extending market access is the driving force behind the GATT. Hindsight suggests that GATT’s rules would have been more useful had they provided guidance as to how to rectify the loss of market access to outside countries that is implicit in the formation of a preferential arrangement. The foregoing by countries outside of a regional arrangement of their most-favoured nation (MFN) right should be treated as a concession: the implementation of any regional arrangement should be followed by negotiation between that arrangement and its outside trading partners, with a view to reducing, on an MFN basis, the external barriers of that arrangement.

1 GATT provisions for regional arrangements

To understand how the international community has influenced regional arrangements, it is useful to recall a bit of history. Post-World War II deliberations on institutional arrangements for the world economy were successful in establishing the International Monetary Fund (IMF) and the World Bank. The International Trade Organization (ITO) was to be for trade what the IMF is for monetary–macroeconomic policy, and the World Bank is for development. A New York Times editorial of April 1947 expressed well the sentiment of the international community toward the proposed ITO: ‘[T]he first and most basic requirement was a charter setting forth the general rules under which trade should be conducted among the nations’ (April 10 1947, p. 24, column 2).

Though the ITO negotiations to establish international stewardship of the trading system were unsuccessful, the community of nations did reach agreement on a more limited matter. Putting matters of economic principle aside, the international community fell back on the traditional mercantilist perception that a country had to ‘buy’ access to another country’s market by giving up access to its own – i.e., that exports were the gains from trade and imports the cost. They agreed to a package of reciprocal tariff reductions and bindings. The document or contract which gave legal effect to this agreed exchange was labelled the General Agreement on Tariffs and Trade, the GATT.

The GATT has the functional parts of a well-written contract. It specifies what was to be delivered by each party, it specifies circumstances
under which a party can go back on the deal (and what compensation that party will then owe others), and what a party can do when it feels that what it has claim to under the contract is not being delivered. More familiar labels for these three parts are (i) exchange of concessions, (ii) exceptions, and (iii) dispute settlement. Provisions for regional arrangements are part of the exceptions – one of the ways to go back on the basic agreement to provide non-discriminatory market access.

1.1 The exception for regional arrangements

Because regional arrangements have been a part of international commerce for a long time, provisions for such arrangements have a long history of inclusion in commercial treaties. Viner (1950) lists, for example, the ‘Iberian clause’ in a 1893 commercial treaty between Spain and Portugal that provided for reciprocal free entry, and the ‘Cuban Clause’ in trade treaties between the United States and Cuba from 1903 until the early 1950s (see also Chapter 3 in this volume).

The argument for including in GATT provisions for regional arrangements was, in large part, the reality that such arrangements existed and would probably continue to be a part of international commercial arrangements. At the time the GATT was negotiated, Belgium and the Netherlands were discussing joining together in a CU. There are also statements from developing country delegates explaining the utility of CUs for development purposes, i.e., among countries each of whose market was too small to allow development of industry (United Nations, 1946a, p. 9).

The downside of this was that allowance for regional arrangements would constitute an exception to the MFN obligation. At a practical level, the United States saw the MFN obligation as a major tool for forcing the end of metropole-colony preferential arrangements, particularly Commonwealth preferences (Jackson, 1969, p. 576). At a more abstract level, the MFN obligation played a critical role in taming the mercantilist dynamics on which the GATT is built into a liberal, global system. As Martin Wolf (1988, pp. 72–3) lucidly states the matter:

Nondiscrimination is . . . central to a system whose principal technique of liberalization is reciprocity and whose principal sanction is retaliation. It is nondiscrimination that creates a global order out of an essentially mercantilist system. By virtue of nondiscrimination purely bilateral bargains become available to all participants, even those with little effective capacity to negotiate. Furthermore, the commitment to nondiscrimination puts the retaliatory power of the strong behind the complaints of the weak.

1.2 Substantive requirements

The language of GATT Article XXIV, paragraph 5, that permits regional arrangements is as follows:

The provisions of this Agreement shall not prevent . . . 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 a free trade area.

The substantive qualifications are these:

1a For a CU, ‘the [common] duties and other regulations of commerce shall not on the whole be higher or more restrictive than the general incidence of . . . [those] applicable in the constituent territories prior to the formation of . . . or the adoption of such interim agreement’ (paragraph 5).

1b For a FTA ‘the [individual] duties and other regulations of commerce shall not be higher or more restrictive than the corresponding duties and other regulations of commerce existing . . . prior to’ (paragraph 5).

2. Paragraph 8 specifies that ‘duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles . . .) are eliminated with respect to substantially all the trade between the constituent territories’ in products originating in these territories.

3. Creation of the union or area can come in stages, if an interim agreement includes a plan and schedule for forming it.

1.3 Enforcement processes

Rules are one thing; convincing countries to keep their policies in line with them is another. What provisions does the GATT make for seeing
that countries honour these specifications when they form a CU or an FTA?

Paragraph 7 of Article XXIV sets out notification requirements. The first subparagraph requires that any contracting party:

- 'deciding to enter into a customs union or a free trade area, or an interim agreement leading to [such] . . .
- shall promptly notify the contracting parties . . .
- shall make available to them such information'.

The next subparagraph provides for the Contracting Parties to review the submitted plan and schedule, and to consult with the parties to the proposed arrangement. If the Contracting Parties find that the agreement will not create or lead to a CU or a FTA within GATT's specifications,

- 'the Contracting Parties shall make recommendations . . .
- the parties shall not maintain or put into force . . . such agreement if they are not willing to modify it in accordance with these recommendations'.

There is also provision that any substantial change in the plan and schedule of agreement be notified, reviewed, etc.

Another 'what to do about it' provision relates to a tariff rate being increased when a CU is formed. Suppose Germany's tariff on bicycles is 5 percent and France's is 15 percent, both rates bound under the GATT. When the two countries form a CU, the common tariff rate becomes 10 percent. In this instance, Article XXIV, paragraph 6 provides that the 'modification' provisions of Article XXVIII are applicable.

Article XXVIII provides that a bound rate may be raised under certain circumstances through negotiation with exporting countries, and that if, say, Germany raises its tariff rate on one product, exporters have a right to compensatory reductions of the German tariff on other products. Article XXIV, paragraph 6 provides that when a CU is formed, exporting countries may ask for these compensation negotiations. Paragraph 6 also modifies the specification of when the exporters may ask for compensation. In our example, the reduction of the French tariff on bicycles is to be taken into account as compensation for the German increase.

If review by the Contracting Parties ruled that a proposed CU or an FTA did not meet GATT's criteria, the countries proposing it would be forbidden from putting it into force. Their options would include the following:

- they could modify their agreement,
- they could withdraw from the GATT,
- they could attempt to convince the contracting Parties to accept by two-thirds majority vote (i.e., under Article XXIV, paragraph 10) an agreement not entirely within the specifications of the other paragraphs of Article XXIV, or try to obtain a waiver under Article XXV.

If the parties to the regional agreement chose to go ahead without adjusting to the problems pointed out by the Contracting Parties, they would risk the following actions by other GATT members:

- they might be expelled from the GATT,
- other countries, after going through the GATT dispute settlement process, might retaliate.

1.4 The logic of GATT's rules for regional arrangements

What is the logic of these rules? Are they designed to isolate economically sensible departures from non-discrimination, to limit the degree or amount of discrimination that countries put into effect, or what?

1.4.1 Not trade creation – trade diversion Jacob Viner introduced the concepts of trade creation and trade diversion in his book, The Customs Union Issue. The book was published in 1950, well after the GATT negotiations were completed, so it should come as no surprise that GATT's criteria are not the equivalent of saying that regional arrangements are to be judged against the normative standard from which Viner derived his concepts. For example, in Chapter 2 of his examination of the European Common Market, the legal scholar Allen (1960) points out that trade diversion as well as trade creation are clearly compatible with GATT's criteria for an allowable regional arrangement. The concepts, however, soon came into wide use in legal analysis – as well as, of course, in economic analysis. To Dam (1963), for example, trade creation and trade diversion provided a standard for evaluating not only regional agreements, but for evaluating the GATT itself. To Dam, failure of GATT's criteria to rule out a trade-diverting regional arrangement (the Latin American Free-Trade Area, or LAFTA, see below) was reason enough to set aside these criteria.

1.4.2 The GATT- standard 'Yes, but . . .' rule The exception GATT makes to its general principles in allowing regional arrangements is similar to its other exceptions. For example, the safeguards exception (Article XIX) provides that a country may impose a restriction against imports, but only if those imports cause or threaten serious injury to domestic production.

Provisions for regional arrangements are an exception, not to the GATT
principle that trade restrictions should go down, but to the principle that they should be non-discriminatory. Article XXIV provides that import restrictions may be discriminatory, but only when there is big-time discrimination: the countries who discriminate in favour of one another must eliminate (not just reduce) all restrictions on substantially all trade among themselves.

The idea behind allowing only big-time discrimination is to rule out discrimination as an instrument of everyday commercial policy. As explained in the quote from Martin Wolf above, such piecemeal discrimination would make impossible the maintenance of a liberal trading system.

1.4.3 Outside countries must accept the loss A second dimension of Article XXIV is addressed more to 'third countries', countries that remain outside of a regional arrangement. Discriminatory trade liberalisation, the drafters of the GATT understood, would often displace the exports of outside countries. Does GATT tell outside countries that they must accept that loss of trade, (market access) without compensation? The answer Article XXIV provides is 'Yes'. Paragraph 5 requires that the tariffs of a FTA shall not be higher, and its other regulations not more restrictive, than those of its constituent territories. Likewise the common external tariff of a CU shall not, on the whole, be higher or more restrictive than those of its constituent territories. Implicitly, if the tariffs and non-tariff barriers (NTBs) of an FTA or a CU are no higher than the (previous) restrictions of its constituent territories outside countries have no basis for claiming a loss of benefits.6

2 Overall applications

Table 5.1 provides a summary tabulation of regional arrangements that have come under GATT scrutiny. Schott's (1989) listing, on which Table 5.1 is based, covers only arrangements on which a GATT Working Party has completed a report. It does not provide a count of regional arrangements: some arrangements may not have been submitted to GATT for review, in other cases (e.g., creation of the EEC) GATT may have reviewed an arrangement more than once.

According to Schott, the GATT has never censured an arrangement as being incompatible with its standards – and only four arrangements have been formally declared to be compatible: the South Africa–Rhodesia CU, the Nicaragua–El Salvador free trade agreement, Nicaraguan participation in the Central American Common Market (CACM) and the Caribbean Community and Common Market (CARICOM) (see Chapter 9 below).

### Table 5.1. Reviews by the GATT of regional arrangements

<table>
<thead>
<tr>
<th>Description of arrangement</th>
<th>Number</th>
<th>%</th>
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<tbody>
<tr>
<td>European Community is a party</td>
<td>42</td>
<td>59</td>
</tr>
<tr>
<td>(a) Creation of the Economic Community</td>
<td>2</td>
<td>42</td>
</tr>
<tr>
<td>(b) Agreements with European countries that have not become members</td>
<td>6</td>
<td>13</td>
</tr>
<tr>
<td>(c) Agreements with countries that have become members (including accessions)</td>
<td>8</td>
<td>19</td>
</tr>
<tr>
<td>(d) Associations, agreements and conventions with developing countries</td>
<td>26</td>
<td>57</td>
</tr>
<tr>
<td>European Free Trade Association, creation and expansions</td>
<td>4</td>
<td>6</td>
</tr>
<tr>
<td>Other arrangements among developed countries (e.g., Australia–New Zealand)</td>
<td>5</td>
<td>7</td>
</tr>
<tr>
<td>Arrangements among developing countries</td>
<td>12</td>
<td>24</td>
</tr>
<tr>
<td>Developing–developed (not EEC) country arrangements (e.g., US–Israel)</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>Arrangements between Finland and Eastern European Countries</td>
<td>6</td>
<td>8</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>71</strong></td>
<td><strong>100</strong></td>
</tr>
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Of the seventy-one reviews tabulated, well more than half (forty-two) involved the European Community in some way. The Community has free trade agreements (that exclude most agricultural goods) with other Western European countries and an extensive array of associations, agreements and conventions with developing countries.

Regional arrangements among developing countries make up a second large group. In the following sections I will examine how GATT reviewed the formation of the EEC, how it reviewed several of the Community's arrangements with developing countries, and how it reviewed arrangements among developing countries.

3 The European Economic Community (EEC)

The Treaty of Rome, signed on 25 March 1957, marked the beginning of the EEC. The Treaty provided a plan and a twelve-year schedule for eliminating tariffs and quantitative restrictions on internal trade. There was, however, provision for backsliding, and special status for France's
special import taxes. Agricultural products were to be included in the common market, but under special rules for coordinating national farm programmes.

The plan for eliminating restrictions on internal trade left certain matters to be worked out. The common tariff rate on any good would, in principle, be the average of the rates charged on that good by the six countries making up the community. But there were lists of products to be exempted from this principle. As to quantitative restrictions (QRs) on imports from outside the Six, the Treaty called for elimination by the end of the twelve-year transition period of all the national restrictions existing when the Treaty was signed. Members could apply no new ones beyond those permitted under decisions of the Organisation for European Economic Cooperation (OEEC).

The overseas territories of the member-states were to be 'associated' with the EEC. The commercial part of this association would involve preferential tariff reductions by the EEC and by each associate, and likewise preferential increases of import quotas. The overseas territories would not be expected to relax import restrictions needed to develop their industries.

3.1 Review by the GATT

Reviewing the EEC presented an enormous issue for the GATT. In Hudec's words (1975, pp. 195-6):

Although the substance of the rules made sense when applied to the EEC, the very size and importance of the EEC adventure make it unrealistic to expect that permission for its existence had to depend upon conformity with these rules. The EEC was the cornerstone of a new North Atlantic foreign policy, as important as the GATT itself.

Negotiating the Rome Treaty had been a difficult task for the member states, and they would have been reluctant to open its provisions for renegotiation, especially for renegotiation to accommodate the demands of an outside party.

The GATT had up to this time rigorously reviewed proposals for regional arrangements. The European Coal and Steel Community (ECSC), made up of the same member-states as the EEC Six, had been voted a formal GATT waiver, a waiver whose conditions were so strenuous that, according to Patterson (1966, p. 129), they 'virtually modified the Treaty'. And the contracting parties had rigorously monitored the ECSC member-states' behaviour against the terms of the waiver.

But the EEC member-states dug in their heels: 'There can ... be no question either of a readjustment of the Treaty or of any of its provisions, or of waivers or of subjecting the Six to special controls' (quoted by Patterson, 1966, p. 157).

This time the GATT blinked: ['T]he Committee felt that it would be more fruitful if attention could be directed to specific and practical problems, leaving aside for the time being questions of law and debates about the compatibility of the Rome Treaty with Article XXIV of the General Agreement' (GATT, 1959, p. 70).

Putting aside the formal review of the Rome Treaty did not mean an end of contracting parties' attempts to influence the trade policies of the EEC. Negotiation would eventually bring the EEC to make adjustments on trade in manufactured goods that its outside trading partners would consider satisfactory. But, as everyone knows, EEC agricultural policy continues to be a problem.

3.2 Industrial goods

The US government's attitude toward the creation of the EEC – as had been its attitude toward the formation of the ECSC – was strongly favourable. At the beginning, the US position focused on establishing political cohesion and military strength in western Europe: the commercial dimension of the EEC and the ECSC were less important. But other western European countries, countries that traded extensively with the Six, pushed hard to defend their commercial interests.

Legal debate under Article XXVIII over who had claim to what compensation for construction of the common external tariff went on for two years, and was inconclusive (Hudec, 1975, p. 199). The 'practical' strategy that eventually took over was to leave the legal issues in abeyance and deal with the height of the common tariff at a new round of multilateral negotiations. The Dillon Round (1960–1) achieved little, but at the Kennedy Round (1964–7) industrial countries agreed to tariff reductions of about one-third of the initial level on about one-third of their total or two-thirds of their dutiable imports. After the Kennedy Round the EEC negotiated free-trade agreements on industrial goods with nearly all of the other western European countries. It is fair to say that by the mid-1970s the height of the EEC's common tariff on industrial goods was a minor issue in international trade, even to exporters who remained outside of the EEC's extensive network of preferential arrangements.7

3.3 Trade in agricultural goods

At the time the GATT was completed, countries were unwilling to commit themselves to removing all restrictions on agricultural trade. The
GATT allows quantitative restrictions on agricultural imports, but governments are required to restrict domestic production to the same extent that they restrict imports. Governments, however, found even this permissive rule impossible to honour. The first major break with the rule was the waiver voted for US agricultural policy in 1955, but European agricultural policies soon became equally troublesome.

The Rome Treaty included trade in agricultural goods in the common market that was to be created. The Treaty also provided for the establishment of a common agricultural policy among the member-states, but it did not specify the mechanics for this agricultural policy. As the policy developed, an important element in it became the establishment of minimum prices for agricultural products, to be maintained by government purchases and by variable levies on imports, these levies equal to the difference between the world price and the politically established internal price. Countries exporting agricultural products feared that implementation would compromise their access to the EEC market, even lead to EEC surpluses that would compete in third markets.

Negotiation was made difficult by the EEC’s unwillingness to modify its internal programme. Furthermore, the basic instruments of the EEC’s policy were the internal prices and the arrangements for financing them. Negotiating trade policy with outside countries was therefore cumbersome – the focal dimensions of these negotiations, trade policies, were not the focal dimensions of the emerging EEC policy.

At the Kennedy Round, agricultural products were excluded from the across-the-board approach used on industrial goods. The EEC offered at the Round a proposal that could be described as a multilateral version of its minimum price scheme. The proposal gained too little support to be accepted, and in the end hardly any reduction of restrictions on temperate zone agricultural products was agreed.

In later negotiations, the United States pressed the EEC to bind their variable levies to specified ceilings. When this yielded nothing the United States shifted to pressing the EEC to agree to minimum quantities it would import from the United States (Hudec, 1975, p. 202). This was, for example, the strategy the United States followed when Spain and Portugal acceded to the Community.

On agricultural trade, exporting countries have not been satisfied with the compensation and adjustment the EEC has been willing to provide. There have been twenty-five GATT panels on EEC agriculture: more than on any other issue (GATT, 1989); the United States has been the complainant in twelve of these. Likewise, EEC agriculture has been a frequent target of Special ‘301’ cases, all to minimal effect (Office of the US Trade Representative, 1991). And the Uruguay Round, under way since the Fall of 1987, has made little progress. In sum, all the king’s horses and all the king’s men have not been able to bring GATT’s liberal trade objectives to bear on world agricultural trade.

4 Developing countries in regional arrangements

Many of the regional arrangements that have been brought to GATT for review have included developing countries as parties. Of these, a large fraction are associations or agreements between the EEC and one or a group of developing countries.

4.1 Developing countries associated with the EEC

The Rome Treaty provided for a special arrangement to be created between the EEC and all non-European territories enjoying a special relationship with one of the Six when the Rome Treaty was signed. Imports into the Six from these territories would be duty free. The associated territories would, in turn, treat imports from any one of the Six the same as imports from the mother country8 (Patterson, 1966, p. 233). Such arrangements would not come into place immediately, they would be worked out and implemented over time.

The EEC made hardly a gesture to defend the resulting arrangements as consistent with the GATT. When first challenged on the matter, spokespersons for the EEC explained that these arrangements were put in place to comply with a UN resolution asking the richer countries to help the less fortunate to prosper.

To the extent that EEC spokespersons did take up the accord of these arrangements with the GATT, their response can be better described as legalistic than as legal. For example, to demonstrate that an agreement between the EEC and certain African countries did include removal of all trade restrictions on substantially all of trade, the EEC considered the convention of association with eighteen African and Malagasy territories as, legally speaking, eighteen FTAs, each with the six EEC member states and one of the territories as the constituents (GATT, 1966, p. 101). No doubt, in each of these, trade among the Six made up ‘substantially all’ of internal trade.

The EEC was not alone in this casualness toward GATT’s standards for the regional agreement involving developing countries. The idea that trade rules that applied to developed countries should not apply to developing countries was gaining increasing importance in the GATT.
This view, applied by members of a GATT Working Party that examined the EEC association agreements with African and Malagasy states, produced the following conclusion:

Some members of the Working Party took the view that the question of the Convention's consistency with Article XXIV was scarcely relevant since the Article had, in their view, never been meant to apply to free-trade or customs unions arrangements between developed and less-developed countries. In their view, among other things, it was inconsistent with the development of thinking on the question of reciprocity that less-developed countries should have to give preferential access to their markets in return for securing preferences in the markets of developed countries (GATT, 1966, pp. 105–6).

4.2 The import-substitution model of development as GATT policy

The import-substitution theory of economic development was gaining increasing strength within the GATT. Consequently, the following two guidelines became increasingly influential:

(1) import restrictions were an important instrument of economic development, hence developing countries should be excused from the GATT's disciplines against their use; and

(2) the developed countries were pressed to take 'affirmative action' that would help the developing countries: provide unreciprocated reductions - and even preferential reductions - of import restrictions on products of export interest to developing countries.⁹

The acceptance of the EEC's arrangements with developing countries was one demonstration of the strength of this view of trade's role in development. GATT approval of arrangements among developing countries was another.

The idea that developing countries should be given licence to restrict imports was more than a part of the reigning theory of economic development: it was a part of the mercantilist ethic on which the GATT was built. Within this ethic, each country views imports as the costs of trade, exports as the gain. But for all countries to be able to export, all would have to be willing to import, hence the idea of each country accepting an obligation not to restrict imports amounts to the ethical proposition of individual sacrifice for the common good. Within this ethical perspective, it is difficult to ask the weaker members of the group to accept the same level of responsibility as the stronger.

Hudec (1987) in his interpretation of the role of developing countries in the GATT, brings out this factor: 'It is very difficult to convene an enterprise involving rich and poor without having some welfare dimen-

sion to the work . . . [The] inability to resist this need to "give something" has been a constant factor in the dynamics of GATT legal policy' (1987, p. 16). Hudec also points out that bending to developing countries' pressure for a dispensation from GATT legal obligations has a venal as well as an ethical attraction: it is cheaper than bending to their pressures for resource transfers.

In the view of another eminent legal scholar, Jackson (1969, p. 591), the permissive view the Contracting Parties took of protectionist preferential arrangements amounted to, in effect, amending the GATT to include an ITO provision that would have allowed developing countries to exchange tariff preferences:

Although the Havana Charter's special article for developing countries' regional agreements was not incorporated into GATT, in practice it appears that the essence of its provisions may have been followed in GATT.

The following two examples document the point.

4.2.1 Latin American Free-Trade Area (LAFTA) The Montevideo Treaty, signed in February 1960, was designed explicitly to provide infant industry protection and 'complementary industrialisation' within the area it covered. Competition within the region was to be avoided, the regional character of the plan was justified as necessary to allow the necessary economies of scale.¹⁰ Hudec (1975, p. 205) sums up its arrangements as follows:

It was typical of most developing country agreements in two respects. First, it did not even approach the [GATT] requirement of total integration. Second, it was frankly protectionist in tone, for the whole theory of developing country integration was aimed at finding larger sheltered markets for infant industry development.

The GATT's conclusion, however, was that 'the CONTRACTING PARTIES feel that there remain some questions of a legal and administrative nature . . . [and] . . . do not at this juncture find it appropriate to make recommendations to the parties to the Treaty'. The Contracting Parties go on to say that the conclusion does not prevent the parties to the Montevideo Treaty from proceeding with application of it, nor does it prejudice the rights of outside countries to recourse under GATT against actions the parties to the Montevideo Treaty taken under the Treaty (GATT, 1961, pp. 21–2).

4.2.2 Agreement on ASEAN Preferential Trading Arrangements A GATT Working Party was established in November 1977 to examine the provisions of the Agreement on ASEAN Preferential Trading
Arrangements. The agreement provided the framework for a system of preferential trading arrangements involving (1) long-term quantity contracts, (2) purchase finance supported at preferential interest rates, (3) preferences in government procurement, (4) preferential tariffs, and (5) preferential non-tariff barriers. The agreement itself provided only a framework for exchanging preferences on any of these instruments: there was no plan or schedule, but by the time the Working Party was established, the member countries had agreed to two batches of tariff concessions, covering a total of 826 items (out of the tens of thousands in the tariff nomenclatures of the participating countries).

The decision taken by the Contracting Parties noted that (the words in italics are quoted from the decision, as reported in GATT, 1978, pp. 225-6) because:

(1) the parties to the agreement had good intentions – intended to promote economic development through a continuous process of trade expansion among member countries of ASEAN without raising barriers to the trade of other contracting parties,
(2) the parties promised to be cooperative – are prepared . . . to consider the possibility of participating in mutually beneficial trading arrangements with other developing countries, and
(3) were not really doing anything anti-GATT – the Agreement should not constitute an impediment to the reduction or elimination of tariffs and other trade barriers on a most-favored-nation basis, the CONTRACTING PARTIES decide that:

Notwithstanding the provisions of Article I of the General Agreement the participating contracting parties may implement the agreement in accordance with the conditions and procedures set out hereunder.

The conditions were that the ASEAN parties continue to have good intentions – any preferential treatment . . . be designed to facilitate trade between the participating States and not to raise barriers to the trade of other contracting parties – that they notify the Contracting Parties of their policy actions, and they consult with any contracting party which considers that a benefit to it is being unduly impaired. As to procedures, the Contracting Parties would review (biennially), could recommend . . .

In sum, no substantive limits were placed on what the ASEAN countries might agree.

5 Conclusions and policy applications

The bulk of GATT's stewardship over regional arrangements is made up of its experiences with the European Common Market and with regional arrangements among developing countries. Neither of these experiences have been supportive of a rule-based, multilateral system. GATT's reviews of developing countries' regional arrangements have been an important part of, in effect, amending GATT to remove all discipline against developing countries' trade restrictions.

The EEC is, arguably, as consistent as is practically possible with Article XXIV's requirements. If we ignore agriculture, the EEC has removed all restrictions (or will have, when 'Europe 92' is completed) on substantially all of internal trade. When the Common Market came into being, the major pressure to break GATT rules came not from the countries that formed the Common Market, but from the countries that were on the outside. Although Article XXIV instructs them to accept their implicit loss of access to the markets of the EEC member-states, they would not accept this loss, and pressed the EEC to make amends. Their sense of a right to the market access they had bargained for in previous GATT tariff conferences was stronger than their sense of obligation to obey the rule in Article XXIV that was in conflict with this instinct. (The GATT began, remember, as an exchange of market access – the ITO negotiations over the rules of commercial policy led to no agreement.)

Responding to such pressures the EEC, at the Kennedy and Tokyo Rounds agreed to significant non-discriminatory reductions of its external tariff on industrial goods. But the EEC went on to take care of the market access concerns of its western European neighbours by negotiating a series of discriminatory arrangements with them; to carry over previous relationships between its member-states and their former colonies through another series of discriminatory arrangements.

Mercantilist respect for a market access bargain obviously weighed in. But systematic concern – concern to preserve the dimension of trade relations that turns these mercantilist bargains into a global system – seems not to have been there. Hudec (1972, p. 1362) after reviewing the discriminatory arrangements negotiated by the EEC, concluded

The seeming collapse of the MFN rule is probably the single most important cause of the present day pessimism about the GATT substantive rules. It [this collapse] is also the largest obstacle to renegotiation of GATT rules generally, for no other rules could have much impact if the EEC practice were generalized.

When the issue was EEC trade in agricultural products, GATT started to fight the right fight – for liberal, non-discriminatory policies. The United States, in particular, pressed for MFN bindings on the Community's variable levies. The fight, however, was lost: the weight of the precedent US agricultural policy had earlier set was no doubt important. In turn, the United States would enter into the game in the spirit of which the European countries were playing it for manufactured goods' trade –
asking for preferential assurances that its exports would be maintained. But this, too, came to little. The Community’s common agricultural policy continues to be illiberal and destabilising of the GATT system: there have been more GATT disputes over EC agricultural policies than over any other issue (GATT, 1989).

GATT’s record with regional arrangements is not, however, as bleak as the above paragraphs might suggest. In 1957, European unification was seen as ‘the only means of restoring Europe to a position of power that will enable it to survive in freedom’ (New York Times, March 26 1957, p. 32); thirty-five years later, we know that Europe has survived, in prosperity as well as in freedom. And it would be hard to argue other than that the rest of the world is better off because of the Community. Breaking a GATT rule in order to allow the rest of the world to press the EEC for a better bargain for outsiders seems a trivial matter.

Another positive note is that the experience of Japan and the Asian NICs has discredited the import-substitution model among developing countries. There is thus less likelihood that developing countries will want to organise regional arrangements that are inward-looking. Indeed, a significant part of Mexico’s motivation to form an FTA with Canada and the United States is to solidify against domestic reaction its own unilateral turn toward openness.

As to lessons for policy, one obvious one is that the procedures Article XXIV outlines for GATT to review and influence regional arrangements as they are being implemented have proved difficult to use. This is not surprising: one of the arguments for regional arrangements is that it is often easier for a few countries than for many to reach agreement. The challenge is to preserve the rights of outside countries against the discriminatory effects of the newly created regional arrangement. One way to do this is to make explicit what the Swedish representative argued about the ECSC: that the foregoing by outside countries of their MFN rights constitutes a concession. Multilateral negotiations, like those that followed the formation of the EEC, might be the best vehicle for cashing in the value of that concession — the lower are trade restrictions, the less consequential is discrimination.

There are other ways to take into account the interests of outsiders, e.g., by removing barriers to their joining the arrangement — following the example of European countries acceding to the EEC, or the US–Canada free trade agreement being superseded by the North American Free-Trade Agreement (NAFTA).

It is easy to think of GATT rules that should be changed: Article VI discipline over anti-dumping (AD) actions and Article XIX discipline over voluntary export restraints (VERs) should be strengthened. It might also be useful, as Jagdish Bhagwati suggests (Chapter 2 in this volume), that countries negotiate CUs and abandon the use of FTAs. The objective, of course, is to change what governments do, not just what is written in the rule book. To the extent, however, that governments see their present practices as defending the market access they have contracted for, they are not likely to agree to such changes.

The international community has long debated if GATT usefulness stems from it being a set of substantive rules or from it being a forum for negotiation. Hudec (1972), arguing the ‘substantive rules’ side, provides an excellent statement of the debate. Using Hudec’s language (his paper is titled ‘GATT or GABB? The Future Design of the General Agreement on Tariffs and Trade’), I insist that GATT’s influence on the EEC is a victory for GABB. Hudec might agree. In 1972 (p. 1377), he was concerned that ‘in some areas, the conditions which permitted successful implementation of the original GATT design may have disappeared entirely. In many other areas, conditions are at best uncertain. It is quite possible, therefore, that GABB may turn out to be the only realistic answer in many parts of GATT’s original domain’.

There is, however, an important and positive lesson in GATT’s experiences with regional arrangements. The lesson is that the value of the market access that countries have bargained for is a powerful motivator for GATT’s procedures. The instinct of countries, when the value of the market it has bargained for is compromised, is to bargain that value back again. Mercantilist self-interest, channelled through GATT’s procedures for consultations, negotiations, peer reviews, etc. has proved to be an effective guard against the abuses of discrimination. The international community can thus take a relaxed attitude toward regional arrangements. Any arrangement that clearly removes trade restrictions deserves the benefit of the doubt. But countries that negotiate regional arrangements must be prepared to negotiate the discriminatory arrangements with their outside trading partners.

A second, perhaps more academic, finding is that it may not be useful to negotiate rules too far ahead of the problems they are intended to resolve. The international community’s best minds put together the Article XXIV rules for regional arrangements, but when actual regional arrangements came along, these rules did not seem relevant. Jackson (1969, p. 588) states the matter diplomatically:

[The basic problem of article XXIV is] criteria that are so ambiguous or so unrelated to the goals and policies of GATT Contracting Parties that the international community was not prepared to make compliance with the technicalities of Article XXIV the sine qua non of eligibility for the exception from other GATT obligations.
view of development worked its way into the GATT legal system. Finger (1991b) contrasts the incorporation of this view into the GATT with the accumulation of evidence favouring the export-led growth model of trade and development.

10 One of the prominent 'vicious circles' of import-substitution theory was that developing countries could not export because their costs were too high, their costs were too high because they could not export and thereby collect the economies of scale that explained the lower costs of industries in the developed countries.

11 Elsewhere (Finger, 1991c), I have argued more generally that GATT rules that helped to implement an agreed trade liberalisation have proved more useful than rules that try to motivate or limit liberalisations.

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NOTES

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1 The interpretation summarised here is presented in more detail in Finger (1991a).

2 Continuation of preferential arrangements in existence when the GATT were signed was provided for elsewhere in the agreement.

3 Article I, the article requiring each contracting party to extend MFN treatment to each other contracting party, accepted already existing preferential arrangements, but specified that margins of preference could not be increased.

4 Paragraph 10 provides for approved backsliding on the requirements. It reads ‘The CONTRACTING PARTIES may by a two-thirds majority approve proposals which do not fully comply with the requirements... provided that such proposals lead to the formation of a customs union or a free-trade area in the sense of this Article’.

5 This discussion is based on Allen (1960, p. 3).

6 There may be some slight basis to argue against this interpretation. In 1952, Norway brought a GATT case against Germany, who had reduced its tariff on sardines imported from Portugal. By art of the German customs nomenclature, sardines imported from Norway were a different tariff category from sardines imported from Portugal, hence Germany’s action did not violate its obligation to provide MFN treatment on Norwegian sardines. Nevertheless, a GATT panel found this to be an instance in which Norway’s rights and privileges under the GATT had been ‘nullified or impaired’, even though Germany’s action was not a GATT violation. In the end, Germany agreed to similar reductions on other categories of sardines. See Hudec (1972, nn. 97 and 193) for a discussion of the case. During the GATT Working Party review of the ECSC, the Swedish representative argued that the foregoing by countries outside the Community of their MFN right constituted a concession. The point failed to achieve majority approval by the Working Party, but the Working Party agreed that any country might take up the point through normal GATT dispute settlement procedures (GATT, 1953, p. 88). No country has tried to make the case, either against the ECSC or against the later Common Market.

7 Almost two-thirds of manufactured goods’ imports by EEC countries come from other EEC member-states. Of the remaining one-third, about one-third comes from other western European countries who enjoy preferential access to the EEC market.

8 The previous arrangements between France and her former colonies were among the preferential arrangements specifically allowed under the annexes to Article I of the GATT.

9 Hudec (1987) provides an excellent depiction of how the import-substitution
Discussion by Jean Baneth


Discussion

JEAN BANETH

In this Discussion, I shall not contradict anything Finger says in his Chapter 5; I will rather try to build on it and make a few complementary remarks.

Of the numerous regional or, as I prefer to call them, limited-membership, trade agreements concluded since World War II, the Euro-

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pean Community alone fully met the formal requirements of GATT Article XXIV; yet none of the others were held up by GATT. These other agreements fall into the following categories:

- The quasi-Community agreements: these bind to each other and to the EC members of the European Free Trade Area (EFTA). These countries generally trade more with the Community than with each other, have effectively eliminated their merchandise trade barriers towards the Community and towards each other in everything but agriculture, and are relatively free traders toward the rest of the world.

- The peri-Community agreements between the Community and developing countries of the (Asia, Pacific and Caribbean) ACP group, of the Mediterranean, and more recently of East Europe. These give free or almost free access to EC markets for non-agricultural goods, and varying degrees of preferential access for agricultural goods. These preferences are applied de facto unilaterally for the ACP group, and with various degrees of asymmetry for the others.

- Finally, from the Montevideo Treaty through ASEAN, a host of preferential trading arrangements among developing countries where neither trade nor preferences usually amount to much.

Finger waxes slightly indignant that GATT has never done anything to stop these arrangements. I wish to point to another aspect of GATT’s role.

GATT is a treaty and an enforcement mechanism, and Finger is right in that most preferential trade agreements constituted breaches to the treaty, yet remained un-sanctioned: GATT did not enforce the treaty. But GATT is also a negotiating forum, and as such it played its role well. The creation and reinforcement of the Community greatly, and perhaps decisively, contributed to a US desire to reduce trade barriers multilaterally, in the Dillon and Kennedy Rounds. Similarly, when the Community grew to 9, and partially merged with EFTA in a Europe-wide free trade area, major new multilateral trade-barrier reductions occurred in the Tokyo Round. When the Community moved to deepen itself to services trade, services were taken up in the multilateral Uruguay Round, which might still bring results. All these multilateral advances occurred in the GATT, and through the use of its negotiating mechanisms.

The Community was the impulse. Beyond economic reasons, strong political forces had to be brought to bear within its members countries to overcome protectionist resistances to lowering trade barriers. It is symptomatic that in France, which initiated the Coal and Steel Community (ECSC) and, with it, the Common Market process, all economic pressure