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TURKEY – RESTRICTIONS ON IMPORTS OF TEXTILE AND CLOTHING PRODUCTS

AB-1999-5

Report of the Appellate Body

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WORLD TRADE ORGANIZATION
APPELLATE BODY

**Turkey – Restrictions on Imports of Textile
and Clothing Products**

Turkey, *Appellant*
India, *Appellee*

Hong Kong, China; Japan; and the Philippines,
Third Participants

AB-1999-5

Present:

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

I. Introduction

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

2. On 6 March 1995, the Turkey-EC Association Council adopted Decision 1/95², which sets out the rules for implementing the final phase of the customs union between Turkey and the European Communities. Article 12(2) of this Decision states:

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

In order to apply what it considered to be "substantially the same commercial policy" as the European Communities on trade in textiles and clothing, Turkey introduced, as of 1 January 1996, quantitative restrictions on imports from India on 19 categories of textile and clothing products.³

¹WT/DS34/R, 31 May 1999.

²Reproduced in WT/REG22/1.

³For a further discussion of the underlying facts and a more detailed description of the products involved in this case, see the Panel Report, paras. 2.2-2.46 and 4.1-4.3, and the Annex to the Report.

3. The Panel considered claims by India that the quantitative restrictions introduced by Turkey were inconsistent with Articles XI and XIII of the GATT 1994, and Article 2.4 of the Agreement on Textiles and Clothing (the "ATC"). In the Panel Report, circulated on 31 May 1999, the Panel reached the conclusion that the quantitative restrictions were inconsistent with the provisions of Articles XI and XIII of the GATT 1994 and consequently with those of Article 2.4 of the ATC, and rejected Turkey's defence that the introduction of any such otherwise GATT/WTO incompatible import restrictions is permitted by Article XXIV of the GATT 1994.⁴

4. On 26 July 1999, Turkey notified the Dispute Settlement Body (the "DSB") of its intention to appeal certain issues of law covered in the Panel Report and legal interpretations developed by the Panel, pursuant to Article 16.4 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU"), and filed a Notice of Appeal pursuant to Rule 20 of the *Working Procedures for Appellate Review* (the "Working Procedures"). On 5 August 1999, Turkey filed its appellant's submission.⁵ On 20 August 1999, India filed an appellee's submission.⁶ On the same day, Hong Kong, China; Japan; and the Philippines filed third participant's submissions.⁷

5. The oral hearing in the appeal was held on 14 September 1999. The participants and third participants presented oral arguments and responded to questions put to them by the Members of the Division hearing the appeal.

II. Arguments of the Participants

A. Claims of Error by Turkey – Appellant

6. Turkey appeals the Panel's finding that Article XXIV of the GATT 1994 does not allow it to introduce, upon the formation of its customs union with the European Communities, quantitative restrictions on textile and clothing products which are inconsistent with Articles XI and XIII of the GATT 1994 and Article 2.4 of the ATC.

7. Turkey argues that the Panel erred in presuming the existence of a conflict between, on the one hand, Articles XI and XIII of the GATT 1994 and Article 2.4 of the ATC, and, on the other, Article XXIV of the GATT 1994. The Panel's reasoning was based on the incorrect presumption that the quantitative restrictions introduced by Turkey in the framework of its customs union with the European Communities were incompatible with Turkey's WTO obligations.

⁴Panel Report, para. 10.1.

⁵Pursuant to Rule 21(1) of the *Working Procedures*.

⁶Pursuant to Rule 22(1) of the *Working Procedures*.

⁷Pursuant to Rule 24 of the *Working Procedures*.

8. According to Turkey, Article XXIV permits the common regulation of commerce of a customs union in a particular sector to be determined by one of the constituent members' lawful quantitative restrictions in that sector, provided that unified regulations are not on the whole more restrictive than the previous regulations of the constituent members.

9. Turkey further contends that Article XXIV is different from exceptions such as Articles XX and XXI of the GATT 1994. The right under Article XXIV to establish a customs union is an autonomous right; it is not an "exception" from other GATT obligations.

10. Turkey argues that the Panel ignored the proper relationship between Article XXIV and the general obligations under the GATT 1994. The Panel did not properly interpret the ordinary meaning of the text of Article XXIV, and, in particular, the chapeau of paragraph 5 of that Article. The ordinary meaning of the chapeau of paragraph 5 demonstrates that Article XXIV confers on WTO Members a right to enter into a customs union, and to derogate, under certain conditions, from their GATT obligations, including, but not limited to, their obligations under Article I.

11. In Turkey's view, other provisions in Article XXIV confirm that forming a customs union or free-trade area is a right of WTO Members. The provisions of Articles XXIV:6, XXIV:7, XXIV:8 and XXIV:9 establish requirements for implementation of a customs union, but do not prohibit its ultimate formation, thereby supporting the proposition that Members have a right to form a customs union under Article XXIV.

12. Turkey argues that there is no textual support for the Panel's conclusion that Article XXIV permits derogations from Article I, but not from other GATT provisions. The chapeau of Article XXIV:5 states that "the provisions of this Agreement" shall not prevent the formation of a customs union, thereby covering all provisions of the GATT 1994, not just Article I.

13. Turkey claims that the Panel's conclusion that Article XXIV:5(a) "does not authorize Members forming a customs union to deviate from the prohibitions contained in Articles XI and XIII of GATT or Article 2.4 of the ATC"⁸ was based on a number of legal errors. First, Turkey argues that the Panel misinterpreted the ordinary meaning of Article XXIV:5(a). Specifically, Turkey argues that the Panel ignored the chapeau to Article XXIV:5. The chapeau clearly states that no GATT 1994 provision shall "prevent" the formation of a customs union as long as certain conditions set out in subparagraph 5(a) are satisfied. The Panel ignored the chapeau, and, as a result, came to the erroneous conclusion that Article XXIV:5(a) does not "authorize or prohibit" the use of quantitative restrictions upon the formation of a customs union.

⁸Panel Report, para. 9.134.

14. Second, Turkey argues that the Panel's reading of Article XXIV:5(a) must fail because it renders the provision a "nullity". The "economic test" established by sub-paragraph 5(a) applies to the duties and regulations of commerce of the customs union as a whole, not, as stated by the Panel, to the duties and regulations of the particular customs union members. Under the Panel's interpretation, the introduction of an otherwise inconsistent measure could disqualify the customs union even though trade flows were, on the whole, facilitated.

15. Third, Turkey argues that the Panel's analysis of "the immediate context" of Article XXIV:5(a) does not support its interpretation of that provision. The Panel failed to include the chapeau of Article XXIV:5(a) in its analysis of the context. Furthermore, the Panel misinterpreted the context of Article XXIV:5(a), in particular, Articles XXIV:5(b), XXIV:4, XXIV:6, and the location of Article XXIV in Part III of the GATT 1994.

16. Turkey also claims that the Panel failed to interpret properly the ordinary meaning of Article XXIV:8(a). The Panel erred by failing to examine the entire context of Article XXIV:8(a), and, therefore, overlooked the interdependent nature of sub-paragraphs 8(a)(i) and 8(a)(ii), and their relationship in the broader context of Article XXIV.

17. Turkey submits that if it is not allowed to impose quantitative restrictions on the textile and clothing products at issue in this case, the European Communities will exclude 40 per cent of Turkey's exports from the customs union between Turkey and the European Communities, thereby leading to an inconsistency with Article XXIV:8(a)(i). Turkey will thus be exposed to a challenge that the proposed customs union does not cover "substantially all trade" and, therefore, is not consistent with Article XXIV.

18. Turkey notes that the Panel stated that Turkey had several alternatives to the imposition of quantitative restrictions: increased tariffs, rules of origin, early phase-out, and tariffication. Each of these suggestions is flawed, and, moreover, Turkey fails to see how the Panel could conclude that Turkey had a duty to opt for one of these alternatives as long as the measures challenged by India did not result in the common regulation of commerce of the Turkey/EC customs union being on the whole more restrictive than the regulations of Turkey and the European Communities before the formation of the customs union.

19. Turkey also argues that the wider context of Articles XXIV:5 and XXIV:8 and the object and purpose of the *WTO Agreement* do not support the Panel's interpretation. Article XXIV:4, the Preamble of the *Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994* (the "*Understanding on Article XXIV*") and the Singapore Ministerial

Declaration do not support a conclusion that the introduction of quantitative restrictions as part of the formation of a customs union is prohibited by Article XXIV.

20. Finally, Turkey argues that the Panel drew the wrong conclusion from past GATT/WTO practice. The Panel concluded from its review of GATT/WTO practice that there is no agreement or acceptance that Article XXIV *authorized or required* the introduction of otherwise GATT/WTO inconsistent measures upon the formation of a customs union. The Panel erred, however, by not reviewing whether GATT/WTO practice *prohibited* the introduction of such measures. Turkey recalls, for example, that during the accession of Sweden to the European Communities, Sweden adopted quantitative restrictions similar to those challenged in this case. In that case, no GATT Contracting Party challenged those measures under Articles XXII or XXIII of the GATT.

B. *Arguments of India - Appellee*

21. India argues that the Panel's ruling that Article XXIV does not authorize the introduction of quantitative restrictions in this case is compelled by the recognized principles of interpretation set out in Articles 31 and 32 of the *Vienna Convention on the Law of Treaties*. The terms of Article XXIV:5 exempt from the other obligations of the GATT 1994 only those measures that are "inherent" in the formation of a customs union. For example, in order to form a customs union, preferential treatment inconsistent with Article I of the GATT 1994 must be granted. By contrast, customs unions can be formed without the introduction of new quantitative restrictions on imports that are inconsistent with Article XI of the GATT 1994.

22. India argues that the context of Article XXIV:5 confirms this interpretation. Article XXIV:4 explains why customs unions are permitted and which purposes they are to serve. Based on the context provided by Article XXIV:4, Article XXIV:5 cannot be interpreted to provide a justification for measures raising barriers to the trade of other WTO Members. Furthermore, the existence in Article XXIV:6 of a mechanism for compensation in the case of increases in tariff duties, without a corresponding provision for compensation for the introduction of new quantitative restrictions, makes clear that Article XXIV was not meant to authorize the imposition of quantitative restrictions.

23. Examining the object and purpose of the *WTO Agreement*, India notes Turkey's argument that the requirements of Article XXIV:5 and Article XXIV:8 apply to the import regimes of the WTO Members forming the customs union taken as a whole, not to individual measures. As there is, however, no mechanism for providing compensation for the introduction of new quantitative restrictions, acceptance of Turkey's argument would induce Members forming a customs union to replace the protection afforded by their tariffs with new quantitative restrictions. This result

contradicts the object and purpose of the drafters, who established a strong prohibition on the use of quantitative restrictions.

24. With respect to Turkey's general claims of legal error, India argues that the Panel did not presume a conflict between the provisions of Article XXIV and the provisions of Articles XI and XIII of the GATT 1994 and Article 2.4 of the *ATC*. The Panel made no such presumption, and simply addressed the question whether there was a need to examine the consistency of the customs union with Article XXIV. Furthermore, in contrast to what Turkey argues, the Panel never stated that Article XXIV was an exception to GATT obligations. The Panel simply noted that Turkey made an "affirmative defence" based on Article XXIV.

25. Next, India responds to Turkey's statement that Article XXIV:5 permits the formation of a customs union as long as the economic assessment in sub-paragraph 5(a) is fulfilled. Article XXIV defines the purposes for which a WTO Member can deviate from other GATT provisions, but does not define the provisions themselves. Only those provisions of the GATT 1994 that "prevent" the formation of a customs union may provide the basis for a defense under Article XXIV. Under the terms of Article XXIV:5, the formation of a customs union is not "prevented" by the obligations set out in Article XI of the GATT 1994 and Article 2.4 of the *ATC*. The formation of a customs union is only "prevented" by those provisions of the GATT 1994 that prohibit discrimination, such as Article I of the GATT 1994 and other most-favoured-nation provisions, because discrimination is inherent in regional integration.

26. India also claims that, contrary to Turkey's argument, the Panel did not rule that Article XXIV justifies only deviations from Article I, and that Article XXIV consequently applied only to tariffs. In fact, the Panel made clear that Article XXIV could permit Members to refrain from applying quantitative restrictions, as well as tariffs, to their partner in the customs union.

27. Finally, according to India, Turkey is unable to explain why the mere fact that a type of measure is regulated in Part III of the GATT 1994 demonstrates that the other Parts of the GATT 1994 no longer apply. Turkey's arguments fail to take into account the reason why the drafters divided the GATT into three parts.

28. With respect to Turkey's specific claims of legal error, India responds to Turkey's objection that the Panel failed to consider the chapeau of Article XXIV:5 in its examination of Article XXIV:5(a) by arguing that the Panel in fact conducted a thorough textual and contextual analysis. In response to Turkey's claim that the Panel's interpretation renders Article XXIV:5(a) a nullity, India argues that Article XXIV:5(a) establishes a requirement that Members forming a customs union must meet in addition to their other market access obligations. This additional

requirement has not been reduced to inutility by the Panel's interpretation. Members forming a customs union may not have bound all their tariffs or may apply their tariffs at levels below the bound rate, or they may have the right to impose quantitative restrictions consistently with one of the exceptions to Article XI of the GATT 1994. In these circumstances, the Members could exercise their right to increase barriers to trade, but only under the conditions set out in Article XXIV:5(a).

29. India also submits that, in contrast to Turkey's claims, the immediate context of Article XXIV:5(a) supports the Panel's interpretation that that provision does not authorize the introduction of quantitative restrictions. In particular, the text of Article XXIV:5(b), Article XXIV:4, and Article XXIV:6, as well as the placement of Article XXIV in Part III of the GATT 1994, all support the Panel's interpretation. India also argues that, contrary to Turkey's claims, the wider context of Articles XXIV:5 and XXIV:8 and the object and purpose of the *WTO Agreement* support the Panel's interpretation of these provisions.

30. Furthermore, India contends that Turkey's claim that the Panel did not properly interpret the ordinary meaning of Article XXIV:8(a) is incorrect. The Panel found that Article XXIV:8(a)(ii) does not provide authorization for Members forming a customs union to violate the prescriptions of Articles XI and XIII of the GATT 1994 or Article 2.4 of the *ATC*. Turkey objects to this interpretation on the ground that it curtails the right of Members with different trade regimes to form a customs union. Turkey fails to take into account that the right to form a customs union is not absolute. Moreover, the Panel's interpretation does not prevent Turkey from forming a customs union with the European Communities, even though it might affect the nature and timing of the formation.

31. Finally, according to India, the Panel drew the correct conclusions from GATT/WTO practice on this issue. The situation here is different from the case involving Sweden's adoption of quantitative restrictions on the occasion of its accession to the European Union, as Turkey did not accede to the European Union. The measures at issue here are simply quantitative restrictions adopted by Turkey in the context of an agreement establishing a customs union with the European Communities.

32. In addition to responding to Turkey's general and specific claims of legal error, India makes a number of general observations. First, the argument that Article XXIV of the GATT 1994 can provide a justification for quantitative restrictions has never been accepted under the GATT 1947. Second, the agreement establishing a customs union between Turkey and the European Communities was drafted on the assumption that Article XXIV does not justify the introduction of new quantitative restrictions on imports of textile and clothing products. This agreement explicitly recognized the possibility that Turkey would not be able to impose quantitative restrictions and that, therefore, a system of certificates of origin would continue to be applied on these products. Third, the agreement

between Turkey and the European Communities provides for the formation of a customs union only at a future date, and therefore constitutes, at most, an interim agreement for the formation of a customs union. To realize the objectives of this interim agreement, Turkey did not have to impose the same restrictions on imports of textiles and clothing as imposed by the European Communities.

III. Arguments of Third Participants

A. *Hong Kong, China*

33. Hong Kong, China argues that Article XXIV is best characterized as a specific provision of the GATT 1994 under which WTO Members are permitted, subject to compliance with certain conditions, to form customs unions or free trade areas that may depart from certain other provisions of the *WTO Agreement*.

34. In interpreting Article XXIV:5, Hong Kong, China notes that it is important to examine the context provided by Article XXIV:4. This paragraph states that the purpose of a customs union or free-trade area is "not to raise barriers to the trade of other contracting parties with such territories." Similarly, the *Understanding on Article XXIV* states that parties to regional trade agreements "should to the greatest possible extent avoid creating adverse effects on the trade of other Members."⁹ It would be contrary to the stated purpose of regional agreements set out in Article XXIV:4 to interpret the chapeau to Article XXIV:5 to permit the raising of barriers to trade in violation of Articles XI and XIII of the GATT 1994.

35. Hong Kong, China also states that, under Article XXIV:8(a), a customs union need not result in a total alignment of the external trade regimes of the constituent territories. Furthermore, Turkey's claims about past GATT/WTO practice on this issue are inapposite. In particular, the circumstances in which Sweden introduced discriminatory quantitative restrictions on imports of textile and clothing products were completely different from those in the present case.

B. *Japan*

36. Japan states that a basic tenet of the *WTO Agreement* is the primacy of the multilateral trading system based on the core principle of the elimination of discriminatory treatment in international trade relations. Members must observe this principle whenever they exercise their rights and obligations under the *WTO Agreement*, including when they enter into regional trade agreements under

⁹Understanding on Article XXIV, Preamble.

Article XXIV of the GATT 1994. Regional trade agreements are only allowed if they are complementary to the multilateral trading system and if they comply with the rules set out in Article XXIV of the GATT 1994.

37. Japan does not believe that Article XXIV functions as a "waiver" which allows derogation from the basic tenets of the multilateral trading system. Furthermore, it should not be interpreted as a waiver of the obligation to eliminate quantitative restrictions, which is a central pillar of the WTO system. Hence, Japan disagrees that Article XXIV gives WTO Members the right to introduce quantitative restrictions in contravention of the *WTO Agreement* on the occasion of the formation of a customs union.

C. *The Philippines*

38. The Philippines first notes that Turkey's invocation of Article XXIV is an affirmative defence to its acknowledged violation of Articles XI and XIII of the GATT 1994 and Article 2.4 of the *ATC*.

39. The Philippines then argues that Turkey's quantitative restrictions are not justified by Article XXIV. First, the quantitative restrictions are not justified because they are on the whole more restrictive than the general incidence of regulations of commerce applicable in the constituent territories prior to the formation of the customs union, in contravention of Article XXIV:5(a). Second, the quantitative restrictions violate Article XXIV:4 because Turkey (and the European Communities) did not avoid creating adverse effects on the trade of other Members to the greatest possible extent. Third, the chapeau of Article XXIV:5 applies solely to the provisions of the GATT 1994 that, if enforced, would prohibit the formation of a customs union. It does not exempt Members from complying with other obligations under the *WTO Agreement*. Fourth, the grounds upon which measures are permitted under Articles XI, XII, XIII, XIV, XV and XX are, by their nature, specific to the Member concerned and, accordingly, cannot be grandfathered.

40. The Philippines also argues that, in any case, Turkey and the European Communities have not formed a customs union. The arrangement between Turkey and the European Communities does not qualify as a customs union under Article XXIV:8 because, *inter alia*, all restrictive regulations of commerce have not been eliminated with respect to substantially all trade between Turkey and the European Communities. In addition, Turkey and the European Communities do not apply substantially the same duties and regulations of commerce to the trade with Members not included in the customs union.

IV. Issue Raised in this Appeal

41. This appeal relates to certain quantitative restrictions imposed by Turkey on 19 categories of textile and clothing products imported from India. Turkey adopted these quantitative restrictions upon the formation of a customs union with the European Communities. The Panel found these quantitative restrictions to be inconsistent with Articles XI and XIII of the GATT 1994 and Article 2.4 of the ATC.¹⁰ The issue raised by Turkey in this appeal is whether these quantitative restrictions are nevertheless justified by Article XXIV of the GATT 1994.

V. Article XXIV of the GATT 1994

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

With regard to the specific relationship between, in the case before us, Article XXIV and Articles XI and XIII (and Article 2.4 of the ATC), we consider that the wording of Article XXIV does not authorize a departure from the obligations contained in Articles XI and XIII of GATT and Article 2.4 of the ATC.

...

[Paragraphs 5 and 8 of Article XXIV] do not ... address any specific measures that may or may not be adopted on the formation of a customs union and importantly they do not authorize violations of Articles XI and XIII, and Article 2.4 of the ATC. ... We draw the conclusion that even on the occasion of the formation of a customs union, Members cannot impose otherwise incompatible quantitative restrictions.¹¹

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

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

¹⁰Panel Report, para. 9.86.

¹¹*Ibid.*, paras. 9.188 and 9.189.

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

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

45. First, in examining the text of the chapeau to establish its ordinary meaning, we note that the chapeau states that the provisions of the GATT 1994 "*shall not prevent*" the formation of a customs union. We read this to mean that the provisions of the GATT 1994 *shall not make impossible* the formation of a customs union.¹² Thus, the chapeau makes it clear that Article XXIV may, under certain conditions, justify the adoption of a measure which is inconsistent with certain other GATT provisions, and may be invoked as a possible "defence" to a finding of inconsistency.¹³

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

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

¹²"Prevent" is defined as "make impracticable or impossible by anticipatory action; stop from happening." *The New Shorter Oxford English Dictionary* (Clarendon Press, 1993), Vol. II, at 2348.

¹³We note that legal scholars have long considered Article XXIV to be an "exception" or a possible "defence" to claims of violation of GATT provisions. An early treatise on GATT law stated: "[Article XXIV] establishes an *exception to GATT obligations* for regional arrangements that meet a series of detailed and complex criteria." (emphasis added) J. Jackson, *World Trade and the Law of GATT* (The Bobbs-Merrill Company, 1969), p. 576. See also J. Allen, *The European Common Market and the GATT* (The University Press of Washington, D.C., 1960), p. 2; K. Dam, "Regional Economic Arrangements and the GATT: The Legacy of Misconception", *University of Chicago Law Review*, 1963, p. 616; and J. Huber, "The Practice of GATT in Examining Regional Arrangements under Article XXIV", *Journal of Common Market Studies*, 1981, p. 281. We note also the following statement in the unadopted panel report in *EEC – Member States' Import Regimes for Bananas*, DS32/R, 3 June 1993, para. 358: "The Panel noted that Article XXIV:5 to 8 permitted the contracting parties to *deviate from their obligations under other provisions of the General Agreement* for the purpose of forming a customs union ...". (emphasis added)

The chapeau of paragraph 5 refers only to the provisions of the GATT 1994. It does not refer to the provisions of the ATC. However, Article 2.4 of the ATC provides that "[n]o new restrictions ... shall be introduced *except under* the provisions of this Agreement or *relevant GATT 1994 provisions*." (emphasis added) In this way, Article XXIV of the GATT 1994 is incorporated in the ATC and may be invoked as a defence to a claim of inconsistency with Article 2.4 of the ATC, provided that the conditions set forth in Article XXIV for the availability of this defence are met.

A customs union shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that

- (i) duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated with respect to *substantially all the trade* between the constituent territories of the union or at least with respect to substantially all the trade in products originating in such territories, and,
- (ii) ... *substantially the same* duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union. (emphasis added)

48. Sub-paragraph 8(a)(i) of Article XXIV establishes the standard for the *internal trade* between constituent members in order to satisfy the definition of a "customs union". It requires the constituent members of a customs union to eliminate "duties and other restrictive regulations of commerce" with respect to "substantially all the trade" between them. Neither the GATT CONTRACTING PARTIES nor the WTO Members have ever reached an agreement on the interpretation of the term "substantially" in this provision.¹⁴ It is clear, though, that "substantially all the trade" is not the same as *all* the trade, and also that "substantially all the trade" is something considerably more than merely *some* of the trade. We note also that the terms of sub-paragraph 8(a)(i) provide that members of a customs union may maintain, where necessary, in their internal trade, certain restrictive regulations of commerce that are otherwise permitted under Articles XI through XV and under Article XX of the GATT 1994. Thus, we agree with the Panel that the terms of sub-paragraph 8(a)(i) offer "some flexibility" to the constituent members of a customs union when liberalizing their internal trade in accordance with this sub-paragraph.¹⁵ Yet we caution that the degree of "flexibility" that sub-paragraph 8(a)(i) allows is limited by the requirement that "duties and other restrictive regulations of commerce" be "eliminated with respect to substantially all" internal trade.

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

¹⁴Panel Report, para. 9.148.

¹⁵*Ibid.*, para. 9.146.

to trade with third countries; instead, it requires that *substantially the same* duties and other regulations of commerce shall be applied. We agree with the Panel that:

[t]he ordinary meaning of the term "substantially" in the context of sub-paragraph 8(a) appears to provide for both qualitative and quantitative components. The expression "substantially the same duties and other regulations of commerce are applied by each of the Members of the [customs] union" would appear to encompass both quantitative and qualitative elements, the quantitative aspect more emphasized in relation to duties.¹⁶

50. We also believe that the Panel was correct in its statement that the terms of sub-paragraph 8(a)(ii), and, in particular, the phrase "substantially the same" offer a certain degree of "flexibility" to the constituent members of a customs union in "the creation of a common commercial policy."¹⁷ Here too we would caution that this "flexibility" is limited. It must not be forgotten that the word "substantially" qualifies the words "the same". Therefore, in our view, something closely approximating "sameness" is required by Article XXIV:8(a)(ii). We do not agree with the Panel that:

... as a general rule, a situation where constituent members have "comparable" trade regulations having similar effects with respect to the trade with third countries, would generally meet the qualitative dimension of the requirements of sub-paragraph 8(a)(ii).¹⁸

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

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

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

¹⁶Panel Report, para. 9.148.

¹⁷*Ibid.*

¹⁸*Ibid.*, para. 9.151.

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

53. With respect to "duties", Article XXIV:5(a) requires that the duties applied by the constituent members of the customs union *after* the formation of the customs union "shall *not* on the whole be *higher* ... than the *general incidence*" of the duties that were applied by each of the constituent members before the formation of the customs union. Paragraph 2 of the *Understanding on Article XXIV* requires that the evaluation under Article XXIV:5(a) of the *general incidence of the duties* applied before and after the formation of a customs union "shall ... be based upon an overall assessment of weighted average tariff rates and of customs duties collected."¹⁹ Before the agreement on this Understanding, there were different views among the GATT Contracting Parties as to whether one should consider, when applying the test of Article XXIV:5(a), the *bound* rates of duty or the *applied* rates of duty. This issue has been resolved by paragraph 2 of the *Understanding on Article XXIV*, which clearly states that the *applied* rate of duty must be used.

54. With respect to "other regulations of commerce", Article XXIV:5(a) requires that those applied by the constituent members *after* the formation of the customs union "shall *not* on the whole be ... *more restrictive* than the *general incidence*" of the regulations of commerce that were applied by each of the constituent members *before* the formation of the customs union. Paragraph 2 of the *Understanding on Article XXIV* explicitly recognizes that the quantification and aggregation of regulations of commerce other than duties may be difficult, and, therefore, states that "for the purpose of the overall assessment of the incidence of other regulations of commerce for which quantification and aggregation are difficult, the examination of individual measures, regulations, products covered and trade flows affected may be required."²⁰

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

¹⁹Paragraph 2 of the *Understanding on Article XXIV* further states that "this assessment shall be based on import statistics for a previous representative period to be supplied by the customs union, on a tariff-line basis and in values and quantities, broken down by WTO country of origin."

²⁰In paragraph 43 of its appellant's submission, Turkey argues that this provision must be interpreted as allowing the constituent members of a customs union to introduce GATT/WTO inconsistent quantitative restrictions upon the formation of the customs union. We see no basis for such an interpretation.

... that the effects of the resulting trade measures and policies of the new regional agreement shall not be more trade restrictive, overall, than were the constituent countries' previous trade policies.²¹

and we also agree that this is:

an "economic" test for assessing whether a specific customs union is compatible with Article XXIV.²²

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

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

57. According to paragraph 4, the purpose of a customs union is "to facilitate trade" between the constituent members and "not to raise barriers to the trade" with third countries. This objective demands that a balance be struck by the constituent members of a customs union. A customs union should facilitate trade within the customs union, but it should *not* do so in a way that raises barriers to trade with third countries. We note that the *Understanding on Article XXIV* explicitly reaffirms this purpose of a customs union, and states that in the formation or enlargement of a customs union, the constituent members should "to the greatest possible extent avoid creating adverse affects on the trade of other Members".²³ Paragraph 4 contains purposive, and not operative, language. It does not set forth a separate obligation itself but, rather, sets forth the overriding and pervasive purpose for Article XXIV which is manifested in operative language in the specific obligations that are found elsewhere in Article XXIV. Thus, the purpose set forth in paragraph 4 informs the other relevant paragraphs of Article XXIV, including the chapeau of paragraph 5. For this reason, the chapeau of paragraph 5, and the conditions set forth therein for establishing the availability of a defence under Article XXIV, must be interpreted in the light of the purpose of customs unions set forth in paragraph 4. The chapeau cannot be interpreted correctly without constant reference to this purpose.

²¹Panel Report, para. 9.121.

²²*Ibid.*, para. 9.120.

²³*Understanding on Article XXIV*, Preamble.

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

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

60. More specifically, with respect to the first condition, the Panel, in this case, did not address the question of whether the regional trade arrangement between Turkey and the European Communities is, in fact, a "customs union" which meets the requirements of paragraphs 8(a) and 5(a) of Article XXIV. The Panel maintained that "it is arguable" that panels do not have jurisdiction to assess the overall compatibility of a customs union with the requirements of Article XXIV.²⁴ We are not called upon in this appeal to address this issue, but we note in this respect our ruling in *India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products* on the jurisdiction of panels to review the justification of balance-of-payments restrictions under Article XVIII:B of the GATT 1994.²⁵ The Panel also considered that, on the basis of the principle of judicial economy, it was not necessary to assess the compatibility of the regional trade arrangement between Turkey and the European Communities with Article XXIV in order to address the claims of India.²⁶ Based on this reasoning, the Panel assumed *arguendo* that the arrangement between Turkey and the European Communities is compatible with the requirements of Article XXIV:8(a) and 5(a) and limited its examination to the question of whether Turkey was permitted to introduce the quantitative restrictions at issue.²⁷ The assumption by the Panel that the agreement between Turkey

²⁴Panel Report, para. 9.53.

²⁵Adopted 22 September 1999, WT/DS90/AB/R, paras. 80 – 109.

²⁶Panel Report, para. 9.54.

²⁷*Ibid.*, para. 9.55.

and the European Communities is a "customs union" within the meaning of Article XXIV was not appealed. Therefore, the issue of whether this arrangement meets the requirements of paragraphs 8(a) and 5(a) of Article XXIV is not before us.

61. With respect to the second condition that must be met to have the benefit of the defence under Article XXIV, Turkey asserts that had it not introduced the quantitative restrictions on textile and clothing products from India that are at issue, the European Communities would have "exclud[ed] these products from free trade within the Turkey/EC customs union".²⁸ According to Turkey, the European Communities would have done so in order to prevent trade diversion. Turkey's exports of these products accounted for 40 per cent of Turkey's total exports to the European Communities.²⁹ Turkey expresses strong doubts about whether the requirement of Article XXIV:8(a)(i) that duties and other restrictive regulations of commerce be eliminated with respect to "substantially all trade" between Turkey and the European Communities could be met if 40 per cent of Turkey's total exports to the European Communities were excluded.³⁰ In this way, Turkey argues that, unless it is allowed to introduce quantitative restrictions on textile and clothing products from India, it would be prevented from meeting the requirements of Article XXIV:8(a)(i) and, thus, would be prevented from forming a customs union with the European Communities.

62. We agree with the Panel that had Turkey not adopted the same quantitative restrictions that are applied by the European Communities, this would not have prevented Turkey and the European Communities from meeting the requirements of sub-paragraph 8(a)(i) of Article XXIV, and consequently from forming a customs union. We recall our conclusion that the terms of sub-paragraph 8(a)(i) offer some – though limited – flexibility to the constituent members of a customs union when liberalizing their internal trade.³¹ As the Panel observed, there are other alternatives available to Turkey and the European Communities to prevent any possible diversion of trade, while at the same time meeting the requirements of sub-paragraph 8(a)(i).³² For example, Turkey could adopt rules of origin for textile and clothing products that would allow the European Communities to distinguish between those textile and clothing products originating in Turkey, which would enjoy free access to the European Communities under the terms of the customs union, *and* those textile and clothing products originating in third countries, including India. In fact, we note that Turkey and the European Communities themselves appear to have recognized that rules of origin could be applied to deal with any possible trade diversion. Article 12(3) of Decision 1/95 of the EC-Turkey Association

²⁸Turkey's appellant's submission, para. 56.

²⁹Panel Report, para. 9.153.

³⁰Turkey's appellant's submission, para. 56

³¹*Supra*, para. 48

³²Panel Report, para. 9.152.

Council, which sets out the rules for implementing the final phase of the customs union between Turkey and the European Communities, specifically provides for the possibility of applying a system of certificates of origin.³³ A system of certificates of origin would have been a reasonable alternative until the quantitative restrictions applied by the European Communities are required to be terminated under the provisions of the *ATC*. Yet no use was made of this possibility to avoid trade diversion. Turkey preferred instead to introduce the quantitative restrictions at issue.

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

VI. Findings and Conclusions

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

65. We wish to point out that we make no finding on the issue of whether quantitative restrictions found to be inconsistent with Article XI and Article XIII of the GATT 1994 will *ever* be justified by Article XXIV. We find only that the quantitative restrictions at issue in the appeal in this case were not so justified. Likewise, we make no finding either on many other issues that may arise under

³³Article 12(3) reads as follows:

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

Article XXIV. The resolution of those other issues must await another day. We do not believe it necessary to find more than we have found here to fulfill our responsibilities under the DSU in deciding this case.

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

Signed in the original at Geneva this 23rd day of September 1999 by:

Christopher Beeby
Presiding Member

James Bacchus
Member

Said El-Naggar
Member