

## THE COMMENTARY

TURKEY - RESTRICTIONS ON IMPORTS OF  
TEXTILE AND CLOTHING PRODUCTS

## I. INTRODUCTION

This dispute was the first before the WTO Dispute Settlement Body to involve Article XXIV of the GATT 1994 and the related Understanding on its Interpretation. It has stirred considerable excitement among scholars and practitioners since both the panel and the Appellate Body were called upon to settle a number of interpretative issues with respect to regional trade agreements and their status within the multilateral system of the WTO. The reports inevitably break new legal grounds and provide useful guidance for future practice in the field of free trade areas and customs unions.

Fundamentally, the Appellate Body interpreted Article XXIV, in addition with the Understanding thereon, to the effect that it explicitly acknowledges the competence of panels to judicially review the legality of regional trade agreements. Moreover, it did not indicate that there are limits to the justiciability, neither on legal nor on political grounds. The attitude of both the panel and the Appellate Body to effectively monitor compliance is clearly reflected in their reports. At the same time, they might in principle pave the way for enhanced judicial control of regionalism within WTO dispute resolution. The present dispute relates to the Association between Turkey and the European Communities. Turkey, the Council, and the member states of the then European Economic Community (EEC) signed the *Ankara Agreement* which entered into force on 1 December 1964. This Agreement generally seeks closer economic co-operation and integration between the parties, and it expressly left open the possibility of full membership to the then European Economic Community of Turkey.<sup>1</sup> It has ever since formed the basis for the economic relationship between Turkey and the European Communities envisaging that their common objectives would be reached best, at least for the time being, through a customs union.

On 6 March 1995, the Turkey-EC Association Council adopted Decision 1/95 to enter into force on 1 January 1996. This Decision sets out the modalities for implementing the *final phase* of the Association which has as its objective the completion of the Turkey-EC customs union.<sup>2</sup>

Article 12(2) thereof reads as follows:

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<sup>1</sup> Cf. Article 28 of the *Ankara Agreement*.

<sup>2</sup> Reproduced in WT/REG22/1. Turkey and the European Communities notified the entry into force of the "final phase of the customs union", as well as additional information, to the WTO. As usual, the case was referred to the Committee on Regional Trade Agreements (CRTA) for examination, see G/C/M/8, WT/REG22/M/1 and WT/REG22/M/2. At the time of the proceedings before the panel and the Appellate Body, the CRTA had not yet finalized its examination.

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

The European Communities maintained, at that time, quantitative restrictions and a system of surveillance for 19 categories of textile and clothing products imported from India. It did so undisputedly pursuant to a Council Regulation which was adopted in the context of the Multifibre Arrangement (MFA) and remained in place after the coming into force of the WTO.<sup>3</sup> Subsequently, Turkey introduced, as of 1 January 1996, the same quantitative restrictions on imports from India in order to establish what it considered to be "substantially the same commercial policy" as the European Communities applied to trade in textile and clothing.

## II. DISPUTE SETTLEMENT PROCEDURE

On 21 March 1996, India requested consultations with Turkey pursuant to Article 4.4 of the DSU and Article XXIII:1 of the GATT 1994 regarding the unilateral imposition of quantitative restrictions by Turkey on imports of certain textile and clothing products as from 1 January 1996. However, India and Turkey did not enter into consultations, due to disagreement on the appropriateness of participation of the European Communities, and the dispute could not be resolved at that stage. The Dispute Settlement Body (DSB) was accordingly informed on 24 April 1996.

On 2 February 1998, India formally requested the DSB to establish a panel pursuant to Article 6.2 of the DSU in order to examine the matter in the light of the GATT 1994 and the Agreement on Textile and Clothing (ATC). On 13 March 1998, the DSB established a panel, and the parties to the dispute agreed on the following composition thereof:

Chairman: Ambassador Wade Armstrong  
Members: Dr. Luzius Wasescha  
Mr. Johannes Human

Hong Kong, Japan, the Philippines, Thailand, and the United States reserved their third-party rights in accordance with Article 10 of the DSU. On 14 August 1998, Turkey requested preliminary rulings by the panel on a number of issues. The panel received written submissions by the parties, as well as third parties, and met on 19 September 1998 with Turkey and India on the matter. It issued its preliminary ruling on 25 September 1998.

<sup>3</sup> Council Regulation (EEC) 3030/93 on Common Rules for Imports of Certain Textile Products from Third Countries, adopted by the Council on 12 October 1993. The European Communities notified these restrictions to the Textiles Monitoring Body within the sixty days period pursuant to Article 2.1 of the Agreement on Textile and Clothing (ATC).

On 28 October 1998, the panel addressed a letter to the European Communities seeking certain relevant factual and legal information under Article 13.2 of the DSU. The European Communities answered the specific questions on 13 November 1998. After two substantive meetings with the parties on 5-6 October and 25 November 1998, respectively, the panel submitted its final report on 26 March 1999.

Turkey notified the DSB of its decision to appeal the panel report on 26 July 1999 pursuant to Article 16.4 of the DSU, and filed a Notice of Appeal pursuant to Rule 20 of the Working Procedure for Appellate Review. The members of the Appellate Body hearing the case were Christopher Beeby (Presiding), James Bacchus and Said El-Naggar. Turkey and India filed their submissions on 5 and 20 August 1999, respectively, and Hong Kong, Japan, and the Philippines again participated as third parties. The Appellate Body issued its report on 23 September 1999.

### III. CLAIMS

#### 1) India

India requested the panel to rule that the import restrictions which Turkey had imposed since 1 January 1996 in the context of its trade agreement with the European Communities on textile and clothing products from India:

- (i) were inconsistent with Articles XI and XIII of the GATT 1994 and Article 2.4 of the ATC and were not justified by Article XXIV of the GATT 1994, and;
- (ii) impaired benefits accruing to India under Articles XI and XIII of the GATT 1994 and Article 2.4 of the ATC.

India requested the panel to base its rulings and recommendations on the following findings:

- (i) Article XXIV:5 of the GATT 1994 did not permit members forming a customs union to impose quantitative restrictions on imports from third members;
- (ii) to the extent that there was a conflict between the provision of Article 2.4 of the ATC and that of Article XXIV:8 of the GATT 1994, the former prevailed; and
- (iii) Turkey had not rebutted the presumption that its restrictions on imports of textiles and clothing impaired benefits accruing to India under Articles XI and XIII of the GATT 1994 and Article 2.4 of the ATC.

## 2) Turkey

As a preliminary matter, Turkey responded by requesting the panel to immediately rule on the following claims *in limine litis*:

- (i) India's request for the establishment of the panel did not meet the specificity requirements of Article 6.2 of the DSU;
- (ii) the panel should dismiss India's claims because they are directed only against Turkey while the measures at issue were taken pursuant to a regional trade agreement between Turkey and the European Communities. Accordingly, the European Communities should also have been a party to the dispute;
- (iii) India would have been required to exhaust the special dispute settlement procedures under the ATC first before it could refer the matter to the DSB. Consequently, the panel had not been established properly.

Turkey also raised a fourth procedural issue for which it did not request an immediate *in limine litis* ruling. It claimed that India had not sufficiently exhausted the avenues of Article XXII of the GATT 1994 and Article 4 of the DSU in order to bring about an amicable settlement and adjustment of the dispute.

In addressing the substantive claims brought forward by India, Turkey submitted that:

- i) it had not acted inconsistently with its rights and obligations under the GATT 1994 and the ATC, and;
- ii) even if the panel were to conclude that Turkey's measures violated provisions of the GATT 1994, India's complaint should still be rejected as imports of textile and clothing products from India have increased since the entry into force of the Turkey-EC customs union and the imposition of quantitative restrictions.

## 3) In appeal

Before the Appellate Body, Turkey raised the substantive issue whether the quantitative restrictions as imposed on textile and clothing products imported from India were justified by Article XXIV of the GATT 1994. It appealed the panel's finding that Article XXIV does not allow to introduce, upon the formation of its customs union with the European Communities, quantitative restrictions which are inconsistent with Articles XI and XIII of the GATT 1994 and Article 2.4 of the ATC.

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#### IV. FINDINGS OF THE PANEL

##### 1) Preliminary issues

The panel rejected all preliminary claims brought forward by Turkey:

Firstly, Turkey claimed that India's request for the establishment of a panel did not respect the specificity requirements pursuant to Article 6.2 of the DSU in that it failed to specifically identify the measures at issue and the products subject to those measures. The panel determined that, "while not identified by place and date of publication, the measures at issue were specified by type, by effective date of entry into force and by product coverage."<sup>4</sup> Thus, India's request met the minimum requirements of specificity pursuant to the DSU.

Secondly, the panel rejected Turkey's claim that the European Communities should also have been a party to the dispute, because the measures at issue were taken pursuant to the Turkey-EC customs union. The panel held that "the measures were Turkish measures, as they were adopted by the Turkish government at a date different from the EC measures, and they were applied and enforced by Turkey alone."<sup>5</sup> The panel found that it was, in essence, the European Communities' free decision not to participate as a third party to the dispute.

Thirdly, the panel determined that India was not required to exhaust the special dispute settlement procedures under the ATC first before it could refer the matter to the DSB. The panel found that the measures at issue had not been introduced under the ATC, but rather, as submitted by Turkey, in the context of the formation of its customs union with the European Communities and thus under the GATT 1994. Therefore, the matter was not for the Textile Monitoring Body (TMB) to review first. Article 8.1 of the ATC clearly provides that the special and additional dispute settlement procedures before the TMB only apply when measures are imposed pursuant to the ATC. Consequently, the panel had jurisdiction to adjudicate on the matter.

Fourthly, with respect to the adequacy of consultations, the panel confirmed the view that the only requirements under the DSU are that consultations were in fact held, or were at least properly requested, and that a period of sixty days has elapsed before the establishment of a panel was requested by the complainant. The panel concluded that India had complied with these procedural requirements, and it consequently rejected Turkey's claim.

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<sup>4</sup> Panel report, par. 9.3.

<sup>5</sup> Panel report, par. 9.207.

## 2) Attribution to Turkey of the measures at issue

Under this title, Turkey did not again argue along the line that the European Communities should have participated as "necessary third party". Rather, it submitted that the measures at issue could not be attributed to it and its responsibility, because it could not be held individually liable for acts that were collectively taken by the members of the Turkey-EC customs union through the institutions created by that agreement. Turkey succinctly held that India erroneously directed its complaint against Turkey concerning measures taken by another entity. The panel, however, did not follow this argumentation. It repeated its finding that the quantitative restrictions were adopted by the Turkish government since "they are implemented, applied and monitored by Turkey, for application in the Turkish territory only."<sup>6</sup> The panel concluded, based on additional deliberations, that the measures clearly did not qualify as "EC measures" nor as measures introduced under the Turkey-EC customs union. Furthermore, it mentioned in passing that, in any case, the latter would have lacked membership to the WTO and thus legal standing before a panel.

## 3) *Prima facie* case of violation

Therefore, India was right in directing its complaint against Turkey. The panel subsequently concluded that, given the fact that Turkey did not deny the existence of quantitative restrictions, India has demonstrated a *prima facie* case of violation of Articles XI and XIII of the GATT 1994. As a consequence, the measures at issue necessarily violated Article 2.4 of the ATC *prima facie* as well, in that they constituted *new restrictions* not authorized by the ATC.

## 4) Relationship of Articles XI and XIII to Article XXIV of the GATT 1994

Eventually, the panel addressed Turkey's main defence that the measures at issue were adopted as an inevitable consequence of the formation of its regional trade agreement with the European Communities. According to Turkey, Article XXIV of the GATT 1994, in allowing the formation of customs unions and free trade areas, necessarily authorizes measures such as those adopted by Turkey. The panel first agreed on its competence to examine "any matters arising from the application of Article XXIV" pursuant to paragraph 12 of the Understanding on Article XXIV of the GATT 1994. It then rejected Turkey's argument that, in order to address the claims of India, it was necessary to assess the compatibility of the Turkey-EC customs union with Article XXIV of the GATT 1994 as such. The panel held, in explicit recognition of the *principle of judicial economy*: "Our examination will be limited to the question whether in this case, on the occasion of the formation of the Turkey-EC customs union, Turkey is permitted to introduce WTO incompatible quantitative restrictions against im-

<sup>6</sup> Panel report, para. 9.44.

ports from a third country, assuming *arguendo* that the customs union in question is otherwise compatible with Article XXIV of the GATT."<sup>7</sup>

The panel dismissed the argument that Article XXIV of the GATT 1994 is *lex specialis*. Rather, its provisions are to be applied together with and not separately from the rest of the WTO agreements; according to the panel, they constitute a "single undertaking".<sup>8</sup> In specifically addressing Article XXIV, the panel focused primarily on paragraphs 5(a) and 8(a) thereof as "they provide parameters for the establishment and assessment of a customs union."<sup>9</sup> In conclusion, they do not, according to the panel, address any specific measures that may or may not be adopted on the formation of a customs union nor do they explicitly authorize violations of Articles XI and XIII or Article 2.4 of the ATC. The panel went on to unequivocally state that "even on the occasion of the formation of a customs union, Members cannot impose otherwise incompatible quantitative restrictions."<sup>10</sup>

The panel, with respect to the specific case before it, considered that means for securing the objectives of Turkey in relation to the specific circumstances of forming its customs union with the European Communities existed in the form of alternatives to the imposition of quantitative restrictions. It mentioned as alternatives increased tariffs, rules of origin, early phase-out, and tariffication. The panel expressly pointed out: "In particular, our interpretation of paragraph 8(a)(ii) allows parties to form a customs union, as in this case, where one constituent member is entitled to impose quantitative restrictions under a special transitional regime and the other constituent is not."<sup>11</sup>

#### 5) Absence of nullification and impairment

The panel rejected Turkey's claim that, even if the panel were to conclude that Turkey's measures violated provisions of the GATT 1994, India's complaint should still be rejected as imports of textile and clothing products from India have increased since the entry into force of the Turkey-EC customs union. The panel held that "even if the presumption of nullification of Article 3.8 of the DSU were rebuttable, Turkey had not submitted evidence that the benefits accruing to India under the ATC and GATT had not been reduced or nullified by the introduction of WTO incompatible quantitative restrictions."<sup>12</sup>

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<sup>7</sup> Panel report, par. 9.55.

<sup>8</sup> Panel report, par. 9.187.

<sup>9</sup> Panel report, par. 9.187.

<sup>10</sup> Panel report, par. 9.189.

<sup>11</sup> Panel report, par. 9.190.

<sup>12</sup> Panel report, par. 9.208.

## V. FINDINGS OF THE APPELLATE BODY

The Appellate Body upheld the panel's overall conclusion that Article XXIV of the GATT 1994 did not allow Turkey to adopt, upon the formation of its customs union with the European Communities, quantitative restrictions on the imports in question. However, the Appellate Body, in its conclusion, explicitly stated that "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."<sup>13</sup>

The Appellate Body modified the panel's legal reasoning in a twofold manner: Firstly, it held that, instead of focusing primarily on paragraph 5(a) and 8(a), the *chapeau* of paragraph 5 of Article XXIV of the GATT 1994 is the key provision for resolving the issue in appeal. It stated that "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."<sup>14</sup> The Appellate Body developed a *necessity test* in order to determine whether measures that would violate other provisions of the covered agreements are justified by Article XXIV of the GATT 1994.

Secondly, the Appellate Body elaborated on the definition of a customs union and, particularly, the terms "substantially all the trade" and "substantially the same duties and regulations of commerce" as stipulated in sub-paragraph 8(a)(i) and (ii), respectively, of Article XXIV. In the view of the Appellate Body, "comparable trade regulations having similar effects" do not meet the qualitative standard of "substantially the same duties and other regulations of commerce" pursuant to sub-paragraph 8(a)(ii).<sup>15</sup> A higher degree of "sameness" is required by that term.

## VI. LEGAL COMMENTARY

### 1) Procedural issues

Procedurally, the panel was confronted with two "standard" claims. It confirmed, with respect to both issues, long-standing practice of WTO dispute settlement.

#### a) Specificity requirements

The panel was called upon to examine, once again, the requirements of specificity of a member state's request to establish a panel pursuant to

<sup>13</sup> Appellate Body report, para. 65.

<sup>14</sup> Appellate Body report, para. 45.

<sup>15</sup> Appellate Body report, para. 50.

Article 6.2 of the DSU. Such a request has a twofold objective: i) it subsequently defines the terms of reference of the panel and thus forms the basis for its jurisdiction in a specific dispute; ii) it informs the defending party and potential third parties of both the measures at issue and the legal basis of the complaint. A sufficiently precise and comprehensive request is necessary to ensure the ability of the responding party to appropriately defend itself and generally reflects the significance of *due process* in WTO dispute resolution.

The case law of panels and the Appellate Body to date reveals, at least implicitly, that the *benchmark* whether a request meets the specificity requirements can be set only on a case-by-case basis.<sup>16</sup> In the present dispute, the panel determined that, albeit not identified by place and date of publication, the measures at issue were specified by type, by effective date of entry into force and by product coverage.<sup>17</sup> The panel made explicit reference to the *EC - Bananas* and the *EC - LAN* cases, respectively, and concluded that Turkey was sufficiently informed of the measures at issue and the products they covered.<sup>18</sup> Moreover, India unequivocally indicated the legal basis for its complaint, and, subsequently, the panel's terms of reference were sufficiently clear as well.

In conclusion, the panel correctly held that due process and Turkey's basic rights to defend itself were not impaired. Turkey could not prove that its defence suffered *prejudice* on account of any lack of clarity in India's panel request. Succinctly, this question is the pivotal one, and, as long as it is answered in the negative, there is no rationale to dismiss a claim on grounds of alleged violation of Article 6.2 of the DSU.

It might be worth noting that the panel did not mention the *lack of any consultations* prior to the dispute in this respect. It is conceivable that, in cases in which the parties have met for extensive consultations, the specificity requirements may lose some of their importance, and the standards to meet might therefore be set lower. During the consultation stage, the defending party gets presumably well informed on the matter in dispute and the potential claims set forth by the complainant in subsequent proceedings before a panel. In such a case, a claim to reject a panel request on grounds of alleged violation of the specificity requirements could easily amount to a violation of the *principle of good faith* if the defendant party argues its own case and does not act on behalf of potential third parties or the multilateral character of WTO dispute resolution.<sup>19</sup>

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<sup>16</sup> Subsequently confirmed by the Appellate Body in the *Korea - Definitive Safeguard Measures on Imports of Certain Dairy Products* case, WT/DS98/AB/R, para. 127.

<sup>17</sup> Panel report, para. 9.3.

<sup>18</sup> Cf. *EC - Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R, Appellate Body report, par. 139-44; *EC - Customs Classification of Certain Computer Equipment*, WT/DS62/67/68/AB/R, Appellate Body report, para. 58-73.

<sup>19</sup> Cf. Article 3.10 of the DSU.

**b) Adequacy of consultations**

The present dispute was the first for which a panel was established after no consultations between the parties were held. India formally requested consultations with Turkey pursuant to Articles 3 and 4 of the DSU, but the parties never met as Turkey declined to do so without the presence of the European Communities.

The panel concurred with the panel in the *Korea – Taxes on Alcoholic Beverages* case that “the WTO jurisprudence so far has not recognized any concept of ‘adequacy’ of consultations.”<sup>20</sup> It went on to adopt the view consistently taken by panels and confirmed by the Appellate Body that the only requirements under the DSU are that consultations were in fact held, or were at least properly requested, and that a period of sixty days has elapsed before the establishment of a panel was requested by the complainant.<sup>21</sup> In the present case, India’s request for bilateral consultations was proper pursuant to the DSU, and the sixty days period has lapsed before the establishment of the panel was requested by India on 2 February 1998.

This finding is consistent with the case law so far. According to that, panels are not deemed appropriate to review the content and adequacy of consultations. Therefore, the panel in the present case only deliberated along well-established lines when it examined whether India had complied with its *procedural* duty to initiate the consultation process properly. Likewise, the panel was correct in not judicially reviewing whether an amicable settlement and adjudication of the dispute would have been possible if the parties in fact would have met.

It seems regrettable, albeit a fact, that panels have no mandate to investigate the adequacy of the consultation process that took place prior to the establishment of a panel. Article 4.1 of the DSU directs member states “to strengthen and improve the effectiveness of the consultation procedures”, and Article 3.7 thereof explicitly recognizes that a mutually acceptable solution “is clearly to be preferred.” Consultations play a crucial and integral part in any dispute resolution mechanism and are intended to facilitate a satisfactory settlement of disputes. In essence, the consultation stage is a necessary step before the establishment of a panel with respect to *both* procedure and substance.

As a consequence, it may be desirable not only to qualify the consultation stage as an obligatory *procedural* step but also to recognize its outstanding *sub-*

<sup>20</sup> *Korea – Taxes on Alcoholic Beverages* case, WT/DS75/84/AB/R, panel report, par. 10.19.

<sup>21</sup> Cf. *EC – Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R, panel report, pars. 7.18-19; *Brazil – Measures Affecting Desiccated Coconut*, WT/DS22/AB/R, Appellate Body report, p. 22; *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products*, WT/DS50/AB/R, Appellate Body report, pars. 86-96.

*stantive* role in WTO dispute settlement which is, according to the clear wording of the DSU, not intended nor considered as being contentious.<sup>22</sup> Admittedly, the practical means to achieve such an understanding and, particularly, to "enforce" it in reality is more difficult to outline. It seems debatable whether the content and, subsequently, the outcome of a consultation is by nature ripe for full judicial review. In practice, it is unlikely that panels or the Appellate Body will ever be in a position to develop a "concept of adequacy" for WTO dispute resolution.

## 2) Substantive issues

The present case represents the first dispute in which a panel and the Appellate Body have been called upon to interpret certain legal issues with respect to Article XXIV of the GATT 1994. Four main substantive issues have grasped the focus of scholars' and practitioners' interest:

### a) Jurisdiction to examine the overall WTO compatibility of a customs union

At the outset, the panel had to deal with the issue as to whether and, if so, to what extent it had jurisdiction to examine the compatibility of a customs union with the WTO agreements. This matter is of fundamental importance since the relevance of the compatibility of any measure with the requirements of Article XXIV of the GATT 1994 essentially depends on the legal nature of the dispute settlement mechanism and, particularly, on the binding effect and thus the enforcement of its rulings. Under GATT 1947, judicial examination by panels was generally limited due to the right of the losing party to block the adoption of a panel report. Moreover, the member states seemed to have tacitly agreed on the sensible and highly political nature of the formation of regional trade agreements, and, consequently, they remained reluctant to bring disputes in this respect before panels. In 1993, a panel examined for the first time comprehensively the legality of a free trade area when the *Lomé Convention* was at stake in the first *Bananas* case.<sup>23</sup> Typically, the European Communities rejected the adoption of the report.

Therefore, there was virtually no effective judicial control of the legality of customs unions and free trade areas during the GATT 1947 years. Albeit the enormous economic and political significance, the exact meaning of Article XXIV of the GATT and the legal requirements to establishing a regional trade agreement have never been clarified by panels. This has fundamentally changed with the coming into force of the WTO and the *juridification* of its dispute settlement mechanism. In particular, paragraph 12 of the Understanding on Article XXIV of the GATT 1994 now provides the relevant basis for judicial review:

<sup>22</sup> Cf. Article 3.10 of the DSU.

<sup>23</sup> *ECC - Import Regimes for Bananas*, DS38/R, dated 11 February 1994. See also, in this respect, the *EC - Tariff Treatment on Imports of Citrus Products from Certain Countries in the Mediterranean Region* case, L/5776, dated 7 February 1985.

"The provisions of Articles XXII and XXIII of GATT 1994 as elaborated and applied by the Dispute Settlement Understanding may be invoked with respect to any matters arising from the application of those provisions of Article XXIV relating to customs unions, free-trade areas or interim agreements."

Hence, on its face, the Understanding grants a large review competence to WTO adjudicating bodies. However, the reports of the panel and the Appellate Body in the present case seem to indicate disagreement as to the extent of judicial review.

The panel concluded that, on the basis of the Understanding, it had jurisdiction to examine the quantitative restrictions adopted by Turkey on the occasion of the formation of its customs union with the European Communities: "We cannot find anything in the DSU, Article XXIV or the 1994 GATT Understanding on Article XXIV that would suspend or condition the right of Members to challenge measures adopted on the occasion of the formation of a customs union."<sup>24</sup> However, the panel remained vague with respect to the extent to which it is authorized to examine the *overall* compatibility. It seemed to express the view that independent review of the overall WTO compatibility of a customs union is rather a question to be dealt with by the Committee on Regional Trade Agreements (CRTA) than judicial bodies such as panels and the Appellate Body.<sup>25</sup> The panel determined that regional trade agreements may contain a wide range of measures "all of which could potentially be examined by panels, before, during or after the CRTA examination."<sup>26</sup> But then, it went on:

"However, it is arguable that a customs union (or a free-trade area) as a whole would logically not be a 'measure' as such, subject to challenge under the DSU."<sup>27</sup>

Eventually, the panel found a way not to rule on the matter explicitly. It held that, in recognition of the *principle of judicial economy*, it was not necessary to judicially assess the Turkey-EC customs union as such in order to address the claims brought forward by India.

The Appellate Body subsequently clarified the issue. It could not address the above quoted statement by the panel directly since the assumption that the agreement between Turkey and the European Communities forms a "customs union" within the meaning of Article XXIV of the GATT 1994 was not appealed.

<sup>24</sup> Panel report, para. 9.51.

<sup>25</sup> The WTO General Council established, on 6 February 1996, the Committee on Regional Trade Agreements (CRTA) with the mandate of, *inter alia*, examining all regional trade agreements within the meaning of Article XXIV of the GATT 1994 as notified to the Council for Trade in Goods and those within the meaning of Article V of the GATS as notified to the Council for Trade in Services, respectively; see WT/L/127. It is worth noting that the CRTA operates under the *consensus* rule.

<sup>26</sup> Panel report, para. 9.53.

<sup>27</sup> Panel report, para. 9.53.

Nevertheless, the Appellate Body made it clear that it requires a member state, which invokes Article XXIV as a defence against the incompatibility of a measure with other WTO provisions, to "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."<sup>28</sup> In conclusion, the Appellate Body approved the competence of panels to judicially review the legality of free trade areas and customs unions pursuant to Article XXIV of the GATT 1994. Moreover, it did not indicate that there are limits to the justiciability.<sup>29</sup>

The same holds true, it is submitted, for regional agreements liberalizing trade in services as governed by the GATS. Article V thereof does not make a distinction between customs unions and free trade areas. It is entitled *economic integration*, and from the wording and the spirit of the Article, one can deduce that regional integration in the context of GATS closely resembles a GATT 1994 free trade area.<sup>30</sup> Article V of the GATS is designed on the same premises and economic rationales as are valid with respect to regional trade agreements pursuant to Article XXIV of the GATT 1994. Albeit there is no explicit Understanding similar to that on Article XXIV of the GATT 1994, it seems correct to conclude that regional agreements liberalizing *trade in services* are equally ripe for judicial review as those liberalizing *trade in goods* are.

The Appellate Body's unequivocal finding is correct from a legal point of view. The Understanding on Article XXIV of the GATT 1994 clearly provides for judicial review of free trade areas and customs unions. Moreover, the progressive *juridification* of dispute settlement in the field of international trade regulation requires panels and the Appellate Body to comprehensively review the WTO compatibility of such agreements when called upon by member states to do so.<sup>31</sup> Although such an examination is a very complex undertaking which may include considerations from various economic, legal and political perspectives, agreements liberalizing trade in goods or services nevertheless have to necessarily comply with the substantive requirements as agreed on by all member states and as stipulated in the GATT 1994 and the GATS, respectively. The issue of reviewing a regional agreement is not tantamount to a political question which escapes judicial review. Moreover, the prior examination of a regional arrange-

<sup>28</sup> Report of the Appellate Body, para. 58. The Appellate Body made reference to the *India - Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products* case, WT/DS90/AB/R, in which the panel had jurisdiction to review the justification of balance-of-payments restrictions under Article XVIII.B of the GATT 1994.

<sup>29</sup> Such a view was, at least selectively, confirmed in the *Canada - Certain Measures Affecting the Automotive Industry* case, WT/DS139/AB/R, see panel report, paras. 10.55-56.

<sup>30</sup> The main difference being that Article V of the GATS allows a regional agreement to have only "substantial sectoral coverage" pursuant to subparagraph 1(a) thereof.

<sup>31</sup> It might be recalled, at this point, that the CRTA decides *by consensus*. This casts severe doubts whether one day through unanimous decision a regional trade agreement will be declared inconsistent with Article XXIV of the GATT 1994 or Article V of the GATS by the CRTA.

ment by the CRTA does not constitute *res iudicata* nor does it seriously interfere with a subsequent objective assessment of the agreement by a panel.<sup>32</sup> In conclusion, there are no *legal* limits to bring a dispute on alleged incompatibility of a regional trade agreement with Article XXIV of the GATT 1994 before a panel and, subsequently, the Appellate Body.

**b) Attribution to a member state of a measure taken pursuant to a customs union**

The panel rejected Turkey's claim that the European Communities should also have been a party to the dispute, because the measures at issue were taken pursuant to a regional trade agreement. According to Turkey, the quantitative restrictions resulted from the implementation of the customs union, and India thus directed its complaint against Turkey concerning measures taken by another entity. The panel dismissed these arguments holding that the measures at issue are neither "EC measures" nor "Turkey-EC customs union measures". The panel came to the unequivocal conclusion that "the measures were Turkish measures, as they were adopted by the Turkish government at a date different from the EC measures, and they were applied and enforced by Turkey alone."<sup>33</sup>

The panel based its finding on the grounds that the European Communities, on the one hand, has maintained its own restrictions on the textile and clothing products in dispute pursuant to a Council Regulation.<sup>34</sup> That Regulation only applies to the European customs territory. It is not enforceable in Turkey as an EC measure as such. With respect to the Turkey-EC customs union, on the other hand, the panel stressed that this agreement has not got any legislative body which would have the constitutional authority to enact laws and regulations that would be, as such, applicable to the territory of the customs union.

India thus was correct in directing its complaint only against Turkey. Moreover, the panel noted that, even if the issue were controversial, two arguments could be made against Turkey's claim: firstly, the Turkey-EC customs union is not a WTO member. In that respect, it has not got autonomous legal standing for the purpose of WTO law and therefore its dispute settlement procedures pursuant to the DSU. Secondly, the panel made reference to general public international law and pointed out that, according to the case law as developed by the International Court of Justice (ICJ), where states act through a common organ, each state still is separately answerable for the wrongful act of the common organ. The panel thus concluded that, in the absence of any treaty provision to the contrary, Turkey could, in any case, reasonably be held responsible for the measures taken by the Turkey-EC customs union.

<sup>32</sup> Cf. Article 11 of the DSU.

<sup>33</sup> Panel report, para. 9.207.

<sup>34</sup> See fn. 3.

At the same time, the panel was aware of the fact that the European Communities could have been affected by a negative outcome of the dispute due to its membership to the Turkey-EC customs union. Thus, the panel examined whether the participation of the European Communities in the proceedings might have been necessary. It took note of the fact that the European Communities decided not to participate as a third party pursuant to Article 10 of the DSU. Then, it stated that the DSU does not allow for any other form of participation in panel proceedings: "There is no WTO concept of 'essential parties'."<sup>35</sup> Therefore, the panel drew the conclusion that it simply had no authority to direct that the European Communities be made third-party or that it otherwise participate throughout the panel process. Furthermore, the panel indicated that a decision between Turkey and India could be reached without an examination of the position of the European Communities. The panel underlined its view with extensive reference to the case law as developed by the ICJ "which has not declined to exercise its jurisdiction in cases similar to this one."<sup>36</sup> Moreover, it recalled that it was not called upon, nor did it intend, to review the WTO compatibility of the customs union in dispute as such.

The panel thus seems to establish the principle that a case can be brought against *any* member state of a free trade area or customs union pursuant to Article XXIV of the GATT 1994 if a measure taken in relation with such an arrangement is alleged to be incompatible with WTO law. The further case law will have to clarify whether there might be constellations for which a more subtle concept has to be developed. So far, special treatment in this respect is only advisable in the case of the European Communities which is a member to the WTO and thus has legal personality for the purpose of WTO law.

c) Article XXIV of the GATT 1994 and the scope of flexibility

The panel, in short, adopted a rather strict attitude towards regional trade agreements and limited their scope of flexibility in forming a customs union or free trade area to a great extent. The Appellate Body, however, reversed the panel's findings in this respect. It applied a more liberal approach and developed a *necessity test* interpreting Article XXIV of the GATT 1994 in a way that enables constituent member states to legitimately depart not only from Most-Favoured-Nation Treatment but also from other obligations.

The panel focused primarily on paragraphs 5(a) and 8(a) of Article XXIV of the GATT 1994 and determined that they allow flexibility in the choice of

<sup>35</sup> Panel report, para. 9.11.

<sup>36</sup> Panel report, para. 9.8. The panel also recalled the constellation in the *EC – Regime for the Importation, Sale and Distribution of Bananas* case, WT/DS27/AB/R. Therein, the panel and the Appellate Body addressed the compatibility of EC measures adopted pursuant to the *Lomé Convention* with the WTO agreements, notwithstanding the EC claim that it was required to adopt the measures pursuant to that *Convention* and notwithstanding the fact that its *Lomé* partners were not parties to the dispute.

measures to be put in place on the formation of a customs union. However, the *scope of flexibility* is not unlimited, and the panel concluded that this flexibility does not allow for the introduction of measures otherwise incompatible with the WTO agreements. With respect to the case before it, the panel unequivocally stated:

"The wording of Article XXIV does not authorize a departure from the obligations contained in Articles XI and XIII of GATT and Article 2.4 of the ATC. We base our findings on the nature of the conditional right established in Article XXIV as opposed to the clear and unambiguous obligation in Article XI prohibiting the use of quantitative restrictions, ..." <sup>37</sup>

The panel was guided by the general interpretative principles of public international law, explicitly recalling the *principle of effective interpretation*.<sup>38</sup> Particularly, it considered the wider context of paragraphs 5 and 8 of Article XXIV, as well as the object and purpose of the WTO agreements on the whole, and cited a number of provisions and the Preamble of both the WTO Agreement and GATT 1994. Therefrom, it drew the general conclusion that the objectives of regional trade agreements and those of the GATT and WTO have always been complementary, and "therefore should be interpreted consistently with one another, with a view to increasing trade and not to raising barriers to trade, arguing against an interpretation that would allow, on the occasion of a customs union, for the introduction of quantitative restrictions."<sup>39</sup> According to the panel, the provisions of Article XXIV on regional trade agreements cannot be considered to exempt constituent members of a customs union from "the primacy of WTO rules."<sup>40</sup>

The panel's approach clearly reflects its view that regional trade agreements form an *integral part* of the world trading system rather than an exception therefrom. Consequently, the WTO Agreements constitute a "single undertaking", and the formation of regional trade agreements is not only governed by Article XXIV of the GATT 1994 but has to simultaneously comply with all the obligations in the covered agreements. The panel thus established that the relationship between the multilateral trading system and regional trading blocs is hierarchical; in the case of a conflict, the general obligations under the legal framework of the multilateral system take priority over the legitimate interests to form customs unions or free trade areas on the regional level. Consequently, the panel arrived at the conclusion that departures from WTO obligations should be construed as narrowly as possible and must be explicitly permitted by the GATT 1994 or GATS. As a practical

<sup>37</sup> Panel report, para. 9.188.

<sup>38</sup> Cf. Article 3.2 of the DSU which makes explicit reference to Articles 31 and 32 of the *Vienna Convention on the Law of Treaties*.

<sup>39</sup> Panel report, para. 9.163.

<sup>40</sup> Panel report, para. 9.163.

consequence, this globalistic reading considerably impedes the formation of regional trade agreements.

The Appellate Body reversed this finding. It focused on the *chapeau* of paragraph 5 of Article XXIV of the GATT 1994 and adopted a more liberal view towards the formation of regional trade agreements than the panel did. In essence, it delivered an interpretation which mitigates the relationship of tension between multilateralism and regionalism. Accordingly, the formation of a customs union or a free trade area may justify not only a violation of Most-Favoured-Nation Treatment but also of certain other obligations under the GATT 1994. The Appellate Body expressly pointed out that it did not make a finding, due to the circumstances in the present case, "on the issue of whether quantitative restrictions found to be inconsistent with Article XI and XIII of the GATT 1994 will ever be justified by Article XXIV."<sup>41</sup>

In conclusion, the Appellate Body set forth a two-part test. In a case involving the formation of a customs union, the *justification* of a measure which is inconsistent with certain other GATT provisions is available only when the following two conditions are fulfilled:

- i) 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 5(a) and 8(a) of Article XXIV; and
- ii) 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.

Thus, the Appellate Body developed a *necessity test*. It put the burden of proof on the defending party to the effect that i) the regional trade agreement in dispute is a "customs union" or a "free trade area" as defined by Article XXIV of the GATT 1994, and ii) the measure at issue is *necessary* for the formation of that agreement. As to the first requirement, the issue of whether the Turkey-EC customs union, in the present case, meets the requirements of paragraphs 5(a) and 8(a) of Article XXIV was not appealed before the Appellate Body.

As to the second requirement, Turkey asserted that the European Communities would have excluded these products from free trade within the Turkey-EC customs union if it had not introduced the quantitative restrictions at issue. Both the panel and the Appellate Body dealt with this argument only on the surface. They concurred that Turkey was not necessarily required to apply the quantitative restrictions in order to meet the requirements of sub-paragraph 8(a)(i) of Article XXIV, and, consequently, to form a customs union with the European

<sup>41</sup> Appellate Body report, par. 65.

Communities. Instead, according to them, there existed less trade restrictive alternatives available to Turkey and the European Communities to prevent any possible diversion of trade while at the same time respecting the parameters of both subparagraphs 8(a)(i) and 8(a)(ii). They mentioned, *inter alia*, *rules of origin* in order to distinguish between Turkish and third country textile products. In conclusion, the panel held, and the Appellate Body confirmed, that Turkey failed to satisfy its burden of proof that the formation of the Turkey-EC customs union would have been prevented if it were not allowed to adopt the quantitative restrictions at issue.

d) Definition of "customs union"

Both the panel and the Appellate Body touched upon the definition of a "customs union". Although the panel declined to examine the Turkey-EC customs union as such, it could not avoid to elaborate on the terms "substantially all the trade" and "substantially the same duties and other regulations of commerce" as stipulated in sub-paragraph 8(a)(i) and (ii), respectively, of Article XXIV of the GATT 1994. The Appellate Body's approach, by establishing the *necessity test* in which the defendant party has the burden to demonstrate that its customs union or free trade area complies with the requirements of Article XXIV, inevitably entails a thorough review of the regional trade arrangement in question and thus requires to clearly define the elements of such an agreement.

At the outset, the panel noticed that the member states have never reached agreement on the interpretation of the term "substantially" in the context of Article XXIV. Then, it cautiously held that

"The ordinary meaning of the term 'substantially' in the context of sub-paragraph 8(a) appears to provide for both qualitative and quantitative components."<sup>42</sup>

The Appellate Body subsequently confirmed this finding. It seems to indicate that, for a regional trade agreement to be consistent with Article XXIV, the term "substantially all the trade" requires *cumulatively* that a certain percentage of trade is liberalized *and* no major sector of a national economy is excluded.<sup>43</sup> At the same time, both the panel and the Appellate Body concurred that paragraph 8 of Article XXIV offers "some flexibility" to the constituent members in forming a regional trade agreement. However, the Appellate Body went on to considerably limit this flexibility with respect to both the elimination of duties and other regulations applicable to the internal trade between the constituent members and their common external trade regime.

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<sup>42</sup> Panel report, para. 9.148.

<sup>43</sup> See for an overview of the GATT 1947 "subsequent practice" on this concept *Guide to GATT Law and Practice: Analytical Index*, 1995, Vol. 2, pp. 824-28.

With respect to the *internal trade* between the constituent members governed by subparagraph 8(a)(i), the Appellate Body determined that "substantially all the trade" is "not the same as *all* the trade", but it is also "something considerably more than merely *some* of the trade."<sup>44</sup> The Appellate Body recalled from the wording of this sub-paragraph 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."<sup>45</sup> In conclusion, it remains open where, in a specific case, the benchmark between *all* and merely *some* of the trade exactly will be set. The Appellate Body's statements indicate that it indeed acknowledges a certain scope of flexibility. At the same time, however, its view seems to imply that the exclusion of whole sectors will not be accepted without appropriate justification. As a practical consequence, it is submitted that this ruling may particularly jeopardize many regional trade agreements which completely exclude agricultural products and thus the primary sector of the constituent members.<sup>46</sup> In essence, their exclusion could only be permitted by relying on a justification similar to those provided for in Articles XI through XV and Article XX of the GATT 1994.

With respect to the *common external trade regime* among the constituent members vis-à-vis third countries as stipulated in subparagraph 8(a)(ii), the panel took a more deferential view than the Appellate Body subsequently did. In the panel's view, "comparable trade regulations having similar effects" meet this standard,<sup>47</sup> but the Appellate Body reversed this finding, instead holding that "a higher degree of 'sameness' is required by the terms of sub-paragraph 8(a)(ii)."<sup>48</sup> According to the Appellate Body, "something closely approximating 'sameness' is required by Article XXIV:8(a)(ii)."<sup>49</sup> In conclusion, constituent members of a regional trade agreement do not enjoy a wide margin of manoeuvre in the creation of their common commercial policy. In contrast to the vagueness of the definition of "substantially all the trade", the Appellate Body makes it clear that external trade regimes within a customs union or free trade area need to be essentially *uniform*.

Furthermore, the panel also deliberated on the meaning of sub-paragraph 5(a) of Article XXIV of the GATT 1994. This provision requires that the overall impact of duties and other regulations of commerce resulting from the formation of a customs union or free trade area must not be more trade restrictive than that of its constituent members prior to its formation. Paragraph 2 of the Understanding on Article XXIV of the GATT 1994 provides that the evaluation

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<sup>44</sup> Appellate Body report, para. 48.

<sup>45</sup> Appellate Body report, para. 48.

<sup>46</sup> Interestingly enough, the Turkey-EC customs union itself excludes agricultural products.

<sup>47</sup> Panel report, para. 9.151.

<sup>48</sup> Appellate Body report, para. 50.

<sup>49</sup> Appellate Body report, para. 50.

of the general incidence of the duties and other regulations of commerce "shall in respect of duties and charges be based upon an overall assessment of weighted average tariff rates and of customs duties collected." With respect to the examination of "other regulations of commerce", the Understanding is more vague. The panel held that, as elaborated upon and clarified by the Understanding,

"Paragraph 5(a) provides for an economic assessment (to be performed by the WTO membership as a whole) of the overall effect of the applied tariffs and other regulations of commerce resulting from the formation of the customs union."<sup>50</sup>

Thus, the panel concluded that subparagraph 5(a) provides for an *economic test* for assessing whether a specific customs union or free trade area is compatible with Article XXIV of the GATT 1994. The Appellate Body subsequently confirmed this finding.

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## VII. ECONOMIC COMMENTARY

### Introduction

This case raised difficult legal questions, regarding the relationship between the provisions of the GATT relating to the formation of customs unions (Article XXIV) and other provisions of the GATT relating to the raising of barriers to international trade (Articles XI and XIII). Article 2.4 of the ATC (Agreement on Textiles and Clothing) was also involved.

The economic issues raised by the case were also of interest, concerning as they did the economic changes involved when a country joins an existing customs union.

The case arose because in March 1995 the Turkey-EC Association Council adopted Decision 1/95, which set out the rules for implementing the final phase of the customs union between Turkey and the European Communities. Turkey agreed to 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 consequence, Turkey, as of 1 January 1996, aligned its customs duties on industrial goods imported from third countries with the Common Customs Tariff of the EC. The MFN tariffs applied by Turkey were reduced from roughly

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<sup>50</sup> Panel report, para. 9.121.