Chapter 10

CUSTOMS UNIONS AND FREE TRADE AREAS

Most favoured nation clause is the cornerstone of the General Agreement on Tariffs and Trade. It is also provided in several bilateral commercial treaties concluded between different countries. Even when not provided in treaties, equal treatment to all friendly nations is considered to be an important principle of international comity.

Is the formation of customs unions compatible with the most favoured nation clause? It is, sometimes, advocated that complete or perfect customs unions are compatible with the most favoured nation clause because the formation of a customs union aggregates the member countries into a single entity for commercial purposes and, therefore, the concessions exchanged among members is a domestic matter not covered by the clause. (1) There exists, however, no generally accepted definition of a perfect customs union in international law. Precedents are too few to establish such a definition. Generally speaking, a perfect customs union must fulfill the following conditions:

1) Complete elimination of tariffs and trade and exchange controls against member countries.

2) Uniform tariffs and trade and exchange controls against non-member countries.

3) Pooling of customs revenue and its division among the member countries according to a formula agreed in advance.

(1) Jacob Viner, The Customs Union Issue (New York, 1950) 5-12.
The conditions must be fulfilled in spirit rather than merely to the letter to constitute a complete customs union. The spirit of the second condition, for instance, can be damaged by the addition of different internal duties and taxes by various member countries to a common uniform tariff; this meets the need of the letter of the law as the internal taxes are not covered by the most favoured nation clause. It is doubtful, however, if many customs unions perfect to this degree can be established from the very beginning. Some customs unions might gradually reach this degree of perfection over a long period of transition. Further, the most favoured nation clause operates between different countries and not between different customs entities. Formation of a customs union aggregates the member countries in a single entity only in one respect i.e. customs administration. This does not convert member countries into a single country. They remain different countries in all other respects. Exchange of concessions between them, therefore, cannot be regarded as a domestic matter. Since customs administration is only one (and not very important) of the several characteristics of the territories forming a single country. A complete customs union means hundred per cent preferential treatment among the member countries. It seems illogical to contend that hundred per cent preferences are compatible with the M.F.N. clause whereas those less than hundred per cent are incompatible. It is as illogical as to contend that injuring a person is illegal but killing him is not so. We can conclude, therefore, that the customs unions are incompatible with the M.F.N. clause.

Most favoured nation clause, however, has not hindered the formation of customs unions in the past, nor is it likely to do so
so in future. (2) In the past, formation of unions has been obstructed mostly by the difficulties of reaching an agreement rather than by the M.F.N. clause. An overwhelming number of unions which could reach an agreement were permitted without protests or with unsuccessful protests. Treaties, generally, consider customs unions as an exception to the M.F.N. clause. The General Agreement permits customs unions not because these are compatible with the most favoured nation clause but as an exception to the said clause. It permits customs unions, primarily, on economic grounds. It is considered that in the modern age many countries are too small to generate sufficient economic growth and the rate of economic growth can be accelerated by closer association between these countries. (3)

The General Agreement defines a customs union as the substitution of a single customs territory for two or more customs territories, so that

1) duties and other restrictive regulations of commerce 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

2) substantially the same duties and other regulations of the territories not included in the union. (4)

This definition differs from the earlier mentioned standard definition of a complete customs union in at least two respects. Firstly, it does not require the pooling of customs revenues. Secondly, the two other conditions are required to be fulfilled to

(2) Ibid., 12-14.
(4) Article XXIV, 8a.
a substantial degree instead of completely. The phrase 'to a substantial degree' is very vague and can be taken to mean different things by different parties.

The contracting parties recognise the desirability of enhancing free trade through the promotion of closer integration between the economies of the constituent countries. They further recognise that the purpose of the customs unions should be to promote trade between the constituents and not to raise trade barriers against other contracting parties. (5) Accordingly, the provisions of the Agreement do not prevent the formation of a customs union between the territories of the contracting parties. (6) The permission is subject to the condition that 'the duties and other regulations of commerce imposed at the institution of any such union or interim agreement in respect of trade with contracting parties not parties to such union or agreement shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such union or the adoption of such interim agreement, as the case may be.' (7) In case a particular member wants to raise any duty inconsistent with the provisions of Article 11, it should follow the procedure contained in Article XXVIII. The rise in any duty levied by a contracting party, member of the union, might be required if it wants to make the duty uniform with the corresponding but higher

(5) Article XXIV, 4.
(6) Article XXIV, 5.
(7) Article XXIV, 5a.
duty levied by other members of the union. In determining the compensation in such cases, the compensation already received from the lowering of the corresponding duty levied by other members will be duly considered. This provision is meant to ensure a balancing of benefits to the non-member contracting parties not from individual member contracting parties but from the member contracting parties taken together.

It is not possible, however, to compare the general incidence (or the restrictive effect) of the two different tariff structures. If the uniform rate of duty levied after the formation of the customs union is the arithmetic average of the duties levied by different members before the formation of the customs union, it does not mean that the incidence of the duty remains the same. The incidence of the uniform new rate of duty thus found might be higher than, lower than or equal to that of the old duties of the different member countries.

The mere formation of the customs union increases the restrictive effect of the duties even if levied at the old rates. Suppose that country A was levying an ad valorem duty of 5 per cent on the import of cloth from countries B and C. Further suppose that the cost of production of cloth is higher in B as compared with that in C by 3 per cent. A was importing cloth from C before the formation of the union. Now A and B decide to form a customs union. After the formation of the customs union C's market for cloth in Country A is captured by B because with the elimination of tariffs between B and A, the supply price of B becomes lower than that of C by two per cent. Thus the restrictive effect of A's duty on the import of cloth from C increases with the formation of a customs
union between A and B even if the rate of tariff levied by A remains unchanged. Similarly, the revenue duties might have protective effects after the formation of the union. Thus the height of the tariff structure on the whole will have to be lower after the formation of the customs union if its restrictive effect on the non-member countries is not to be increased.

Any contracting party deciding to enter into a customs union or an interim agreement leading to the formation of such a union is required to notify the Contracting Parties promptly. (8) Further, it is required to submit such information regarding the proposed union as will enable them to make appropriate reports and recommendations to the contracting parties. In case of an interim agreement, the contracting party should submit, within a reasonable time, a plan and a schedule for the formation of a customs union. (9) If, after studying all the information, the contracting parties find that the agreement is not likely to result in the formation of a customs union within the period contemplated by the parties to the agreement, or that the period is not a reasonable one, they shall make recommendations to the concerned parties. The parties are not to maintain or execute the agreement in case they are not willing to modify it in accordance with these recommendations. (10) This provision has two important aspects. (11) Firstly, it empowers the Contracting Parties to prevent the growth of preferential

(8) Article XXIV, 7a.
(9) Article XXIV, 5c.
(10) Article XXIV, 7b.
arrangements in the guise of a customs union. Secondly, in genuine cases, they can guide the parties in the establishment and working of the union.

The preferences permitted by paragraph 2 of the Article I are not affected by the formation of customs unions. (12) According to the definition of a customs union given in Article XXIV, 8a, ii, the contracting parties forming a customs union are required to apply substantially the same duties and regulations or commerce to the trade of contracting parties outside the union. Unless the preferences permitted by paragraph 2 of Article I are specially exempted from this provision, the contracting parties forming a customs union would have to abandon the preferential arrangements. Preferences, however, may be eliminated or adjusted by means of negotiations with affected contracting parties. It follows from Article I that when a product imported into the territory of a member of a customs union at a preferential rate of duty is re-exported to the territory of another member of the union, the latter member should collect a duty that would be payable if the product were being imported directly into its territory.

The Contracting Parties are authorised to approve proposals, by two-thirds majority, which do not fully comply with the requirements of paragraphs 5 and 9 inclusive. (13) This is subject to the condition that such proposals lead to the formation of a customs union in the sense of this Article.

The contracting parties are required to take such reasonable

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(12) Article XXIV, 9.

(13) Article XXIV, 10.
measures as may be available to them for ensuring the observance of the provisions of this Agreement by the regional and local governments and authorities within their territory. (14) This provision is meant to safeguard against possible abuses by local authorities and administrative discrimination. (15)

GATT permits customs unions but prohibits preferences. The only difference between the customs union and preferential arrangements is that the former involves complete discrimination whereas the latter involves partial discrimination against the outside world. The question may be raised as to why hundred per cent preferences are economically good and less than those economically injurious? The only genuine justification for this distinction lies in the administrative economics, for hundred per cent preferences eliminate the need for a machinery administering tariffs and other regulations within the union. Wilcox defends this distinction in the following way:

A customs union creates a wider trading area, removes obstacles to competition, makes possible a more economic allocation of resources, and thus operates to increase production and raise planes of living. A preferential system, on the other hand, retains internal barriers, obstructs economy in production, and restrainsthe growth of income and demand. It is set up for the purpose of conferring a privilege on producers within the system and imposing a handicap on external competitors. A customs union is conducive to the expansion of trade on a basis of multilateralism and non-discrimination; a preferential system is not. (16)

The above defence of the distinction made by Wilcox is more emotional.

(14) Article XXIV, 12.
(15) Muhammad, n. ii, 247.
than logical. If a customs union with hundred per cent preferences creates a wider trading area, removes obstacles to competition, makes possible a more economic allocation of resources, and thus operates to increase production and raise planes of living, there is no reason why less than hundred per cent preferences should not bring in all these benefits to a lesser extent. Similarly, if preferences confer a privilege on producers within the system and impose a handicap on external competitors, the customs union with hundred per cent preferences does so more. Further, it is difficult to understand how Wilcox maintains that customs unions promote trade in a multilateral and non-discriminatory manner. Evidently, the trade is promoted in a regional manner and there is discrimination against the non-member countries. The promotion of trade, thus, is neither multilateral nor non-discriminatory. And this is equally true of partial preferences.

According to Viner, apart from administrative economies, there is only one ground on which it can be established that preferences are economically bad and increasingly so as these approach hundred per cent whereas the customs union is an economic blessing. A complete customs union removes all tariffs within the union. It establishes beneficial as well as injurious preferences, or in other words, trade creating as well as trade diverting ones. "Preferential arrangements, on the other hand, can be, and usually are, selective, and it is possible, and in practice probable, that the preferences selected will be predominantly of the trade-diverting or injurious kind." (17) Viner, however, does not give

(17) Viner, n. 1, 51.
any reason as to why the trade-diverting preferences are likely to be selected and those of a trade-creating nature rejected. Indeed quite the reverse may happen. Trade-diverting preferences are injurious not only to the outside exporters but also to the importing member countries. The importing member countries might not agree to exchange such preferences. Further, trade-diverting preferences arouse protests from the outside countries who were supplying the market before the establishment of the preferences. Such preferences, therefore, might not be established, or dropped, if established, at the protest of the countries whose interests are injured, to avoid any embitterment of international relations.

Trade-creating preferences, on the other hand, are beneficial for the member as well as for the outside countries; outside countries gain from a diffusion of prosperity of the member countries arising from trade-creation. Outside countries, therefore, are likely to welcome such preferences. Thus the probability of a single trade-creating preference being established is greater than that of a trade-diverting one. The scope for trade-diverting preferences, however, is far greater than that for trade-creating ones. In addition, the process of trade creation is very slow whereas trade can be diverted from outsiders more easily and quickly. Thus in spite of the comparatively lower probability of the occurrence of a single trade-diverting preference, trade-diverting preferences are very likely to predominate over the trade-creating ones in a customs union because of the existence of a greater number of total trade-diverting preferences and smaller number of total trade-creating preferences. The ratio of trade-diverting preferences, however, is very likely to be greater in a complete customs union.
and smaller under a selective preference system. Thus a selective preference system is likely to be more beneficial and less injurious than a complete customs union. In the limiting case, if the selective preference system leads to the establishment of all trade-creating and none trade-diverting preferences, it will result in the maximum benefit and minimum loss for the world as a whole.

Thus, if the General Agreement accepts customs unions on economic grounds, the partial preferences especially those of an exclusively trade-creating nature have a greater claim to be accepted. An ideal policy for the Contracting Parties will be to permit neither complete unions nor all selective preferences but only trade-creating preferences. This has the additional advantage that such preferences will not be opposed by the outside contracting parties. Customs unions are opposed by the outside contracting parties whose interests are injured thereby.

Another defence for the distinction is made by John W. Evans. (18) A customs union covers all products traded between the constituent territories. Barring the exceptional case where no imported product is produced domestically in any constituent country, the formation of a customs union promotes competition and division of labour. A preferential arrangement, on the other hand, may include only those imported products of each constituent territory which are not produced domestically. Even if it includes all products, the level of preferential rates may be so determined

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as to grant preferred market only for those products which are not produced domestically. Thus the preferential arrangements may or may not increase competition and the division of labour within the area whereas a customs union is very likely to do so. This argument establishes only that a customs union is likely to be more useful than the preferential arrangements. This does not establish that the customs unions are useful whereas the preferential arrangements are harmful. Whether or not regional arrangements are compatible with multilateralism depends to a considerable extent on the spirit in which these are conceived and implemented. These may be expansionist or restrictive depending on the views and policies of the authorities administering these.

The General Agreement permits the formation of customs unions only between the contracting parties and not between any contracting party and the outside countries.

The General Agreement allows for free trade areas, too. It defines a free trade area as a group of two or more customs territories in which the duties and other restrictive regulations of commerce are eliminated on substantially all the trade between the constituent territories in products originating in such territories. (19) Regarding the abolition of trade barriers between the constituent contracting parties, free trade area and customs union are similar to each other. The difference between the two lies in the fact that the constituents of a customs union are required to adopt a uniform tariff system against the outside

(19) Article XXIV, 8b.
countries while the constituents of a free trade are under no such obligation.

The provisions concerning the formation of the free trade areas are more or less the same as those for the formation of customs unions.

The free trade areas are easy to form. These do not involve the knotty problem of the division of customs revenues among the constituent countries. The low-tariff members are not required to raise their tariffs to bring these in uniformity with those of the high-tariff countries. Nor the high-tariff members required to lower their tariffs to the level of those of the low-tariff countries. Each constituent party is free to adjust its tariffs against the outside party according to the needs of its economy.

Cases Examined

We have examined above the GATT provisions relating to the formation of customs unions and free trade areas. Let us now briefly study some of the customs unions and free trade areas which have been formed under these provisions.

European Economic Community. The Treaty of Rome establishing the European Economic Community, consisting of Belgium, Luxembourg, the Netherlands, the Federal Republic of Germany, France, and Italy, was signed in March 1957. In accordance with the requirements of paragraph 7(a) of Article XXIV of the General Agreement, shortly afterwards the text of the Treaty was submitted to the Contracting Parties. At the twelfth session, the Contracting Parties appointed a committee consisting of representatives of all the countries to the General Agreement for examining the treaty. The Committee
entrusted the work to four sub-groups. A number of issues were raised in these sub-groups. Sub-group A examined the provisions of the Treaty relating to the establishment of a common tariff and the elimination of import and export duties among the members. As the rates of duty were not known for a large part of the common tariff, it was not possible for the sub-group to determine as to whether or not the common tariff was consistent with the provisions of paragraph 5(a) of Article XXIV. Regarding the basis on which the common tariff was to be constructed, any automatic formula like the arithmetic average was not acceptable to most of the members and they held that the matter be approached by examining individual commodities on a country by country basis. (20) In this connection, they drew attention to the drafting history of paragraph 5(a) of Article XXVI according to which the term "general incidence of duties" was used with the intention "that this phrase should not require a mathematical average of customs duties but should permit greater flexibility so that the volume of trade may be taken into account." (21) The representatives of the Member States argued that any method of calculation is not inconsistent with the provisions of Article XXIV so long as the common duty rates are not higher than the general incidence of the duties in force before the formation of the customs union.

Sub-group B considered the provisions relating to the use of quantitative restrictions, particularly those used for balance of

(20) GATT, Basic Instruments and Selected Documents, Sixth Supplement (Geneva, 1958) 71-2.

payments purposes. Members of the sub-group raised objection about the provisions of the Treaty permitting a Member to apply quantitative restrictions not justified by its own balance of payments position. (22) They recognised that this objection would not hold if the integration of the economies reaches the stage in which the constituent members hold their foreign exchange reserves in common. The Members held that the opening phrase of paragraph 5 of Article XXIV provided a general exception under which they are authorised to deviate from other provisions of the General Agreement, including Articles XI to XIV, in so far as these constitute obstacles to the formation of the customs unions. Further the provisions of Article XXIV: 8(a) (ii) required the Members to apply "substantially the same duties and other regulations of commerce." The Members held that the words "other regulations of commerce" included quantitative restrictions. Most of the members of the sub-group did not accept this view and asserted that the words "other regulations of commerce" did not include quantitative restrictions imposed for balance of payments purposes. The provisions of the General Agreement indicate that these words are consistently used to describe such matters as customs procedure, grading and marketing requirements and similar routine controls in international trade. Sub-paragraph 8(a) (i) explicitly permits quantitative restrictions for balance of payments purposes within the constituent members. It does not seem practicable to have uniform quantitative restrictions against third countries when the members are applying restrictions against each other. This arrangement would involve unnecessary restriction.

(22) GATT, n. 20, 76-81.
of trade because certain members would apply quantitative restrictions not required by their own individual balance of payments position. Uniform quantitative restrictions are contrary not only to Article XII but also to fundamental economic reasoning. This means that member countries would not be able to apply restrictions appropriate to their needs. Certain countries would have to apply restrictions without any need for these while others might not be able to apply these to the required extent. This would enhance the difficulties of the member countries in achieving an equilibrium in their individual balance of payments. Unless they apply restrictions within themselves, it would be impossible for them to achieve an equilibrium in their individual balance of payments.

Sub-group C considered the agricultural provisions of the Rome Treaty in relation to the General Agreement. Members of the sub-group excluding the representatives of the constituent countries stated that it was not possible to determine as to whether or not the agricultural provisions of the Rome Treaty were consistent with the provisions of the General Agreement because the Treaty lacked details of the action to be taken and left much to the discretion of the institutions of the community. (23)

Sub-group D examined the provisions of the Rome Treaty relating to the association with the common market of the overseas territories in relation to the provisions of the General Agreement. Some members stated that the Agreement did not visualise that the same group of countries would simultaneously belong to a customs union and a free trade area. (24) One member of the sub-group

(23) Ibid., 88.
(24) Ibid., 90-1.
pointed out that paragraph 5 permits, in case of a customs union, the customs duties in the uniform tariff to differ under certain conditions from those formerly applied in the constituent territories subject to the condition that these are not on the whole higher or more restrictive than the general incidence of the duties in force before the formation of the union; paragraph 5(b), on the other hand, requires that the duties in the tariff of each of the constituents of the free trade area should not be higher than those in force before the establishment of the free trade area. Because the customs union of the Six involves certain increases in those duties, they cannot become members of free trade area without infringing the provisions of paragraph 5(b). This inconsistency between the provisions relating to the formation of customs unions and free trade areas indicates that the authors of Article XXIV did not visualise simultaneous establishment and existence of a customs union and a free trade area. Some members including the representative of the Six, however, did not agree with this view. The representative of the Six stated that in case the authors of the Havana Charter intended to oppose the simultaneous establishment and the co-existence of the two arrangements, they would have included in the Charter explicit provisions to this effect. It is not appropriate to apply provisions which the Agreement does not contain and which the Members have not accepted. The theory of the incompatibility of the co-existence of two arrangements is even less justified than that of the incompatibility of simultaneous establishment. If the Agreement prevented the simultaneous establishment of the two arrangements, the difficulty could be easily overcome by staggering
the establishment of the two arrangements over a period of time, however short it may be.

Regarding the argument based on tariff changes that might possibly result, the representative of the Six stated that the tariff increases which might result in the case of certain members of the free trade area were the consequence of the establishment of the customs union and not that of the establishment of free trade area. As the establishment of the free trade area was not the cause of the increase in the tariffs of certain members, the free trade area was not inconsistent with the relevant provisions of the Agreement. The representative of a country which in 1947 was already a member of a customs union stated that at that time his country's representative had sought and obtained an assurance for permission to associate a customs union and a free trade area. Most members of the sub-group hold the view that the provisions of the Rome Treaty relating to the association of the overseas territories were inconsistent with the provisions of Article XXIV of the General Agreement and such association would be an extension of the preferences authorised under paragraph 2 of Article 1 of the General Agreement to territories not entitled to these. (25) Paragraph 8(b) of Article XXIV requires the territories forming a free trade area to eliminate duties and restrictive regulations of commerce on "substantially all the trade" within themselves. The Treaty infringed on this provision of the Agreement by permitting the associated territories to apply considerable duties on exports to and imports from the territories of the Six. Regarding the

liberalisation of trade between the constituent territories, the representative of the Six stated that the text of the Agreement did not precisely define the term "substantially all." The Rome Treaty visualising liberalisation of 98.6 per cent trade between the European and Overseas territories constituting the free trade area went beyond the requirements of the Agreement. The Six proposed that the term "substantially all" may refer to 80% of the total trade. Many members of the sub-group, however, did not agree with this proposal and said that it would be inappropriate to fix a general figure of the percentage and suggested that each case be examined on its own merits.

Considering that sufficient information, which was essential to complete the examination of the Treaty pursuant to paragraph 7 of Article XXIV, was not available on a number of important matters, the contracting parties decided, at the thirteenth session, to set aside the legal issue for the time being and to direct their attention to specific problems which might arise out of the application of the treaty. (26) The members agreed to furnish information pursuant to paragraph 7(a) of the Article XXIV. They further agreed to hold consultations under Article XXII and to furnish in Article XXII consultations information as to the measure arising out of the application of the treaty.

In March 1961, an agreement was concluded creating an association between the member States of the European Free Trade Association and the Republic of Finland. The Contracting Parties examined the agreement in accordance with paragraph 7 of Article XXIV

(26) GATT, Basic Instruments and Selected Documents, Seventh Supplement (Geneva, 1959) 71.
of the General Agreement. They felt that there remained some legal and practical issues. But, thinking that these cannot be fruitfully discussed further at this stage, they did not find it appropriate to make recommendations to the parties to the Agreement pursuant to paragraph 7(b) of Article XXIV and, therefore, approved the Agreement.

At the Second Session of the Preparatory Committee of the United Nations Conference on Trade and Development held in Geneva from 21 May to 29 June 1963, all the developing countries, excepting the Associated African States and Tunisia, and some agricultural exporting countries like New Zealand and Australia, criticised the policies of the European Economic Community on a number of counts e.g. effect of EEC's policies on imports into EEC from third countries particularly in the field of agricultural commodities, policies of agricultural self-sufficiency adopted by the Six, and the preferential relationships sought to be developed with the Associated African States which in the view of a number of speakers could hamper the efforts of these states to expand trade with other countries in Africa and with developing countries generally.

The Indian delegation pointed out that exports from India and the South East Asian region have not benefited from the general increase in community's purchases from third countries. Further, the level of common tariff and the preferential arrangements developed with Associated States create serious obstacles for exports of manufactured products from developing countries.

Defending the EEC policies, the French delegation stated that the common external tariff was evolved on liberal principles, that the trend towards agricultural self-sufficiency was a reflection
of the revolution in agricultural productivity in Western Europe and that the preferences to the associated states resulted from historical necessity and were an indispensable measure of protection for the export income of these countries until international markets could be organised.

The South Africa-Southern Rhodesia Customs Union. The Interim Agreement for the re-establishment of the customs union between the Union of South Africa and Southern Rhodesia was signed in December 1948 and made effective in April 1949. The issue was brought before the Contracting Parties and a Working Party appointed for its examination. At the report of the Working Party, the Contracting Parties declared that the two governments were entitled to enter into a customs union agreement under Article XXIV of the General Agreement. (27) The two governments undertook to furnish the Contracting Parties i) copies of each annual report of the customs union council, ii) not later than 1 July 1952, report on progress achieved towards the elimination of tariffs and other restrictive regulations of commerce to the trade of the territories of other contracting parties, and iii) not later than 1 July 1954, a definite plan and schedule for the completion of the said union. They further undertook to complete the re-establishment of the union as soon as possible and in any case not later than 1 April 1959. The Contracting Parties reserved the right to review the declaration permitting the customs union in case the study of the reports and plans submitted by the two governments leads them to the conclusion that the Interim Agreement is not likely to result in the formation

(27) GATT, Basic Instruments and Selected Documents (Geneva, 1952) II, 29 and 176-81.
of the customs union by the said date.

On 3 September 1953, the Central African Federation consisting of Southern Rhodesia, Northern Rhodesia and Nyasaland was established. Following the establishment of the Federation, the agreement directed to the formation of a customs union between Southern Rhodesia and South Africa was terminated.

**European Free Trade Association.** The failure of the negotiations, in November 1958, for establishing the European Free Trade Association consisting of the members of the European Economic Community and the other members of the Organisation for European Economic Co-operation led to the decision to establish the European Free Trade Association consisting of the seven viz. Norway, Denmark, Sweden, Austria, Switzerland, Portugal and the United Kingdom. The Stockholm Convention establishing the European Free Trade Association was approved by the participating governments in November 1959 and submitted to the Contracting Parties for examination. The Convention envisages abolition, over a period of ten years, of tariffs and other barriers to trade between members in industrial products. Special agreements are envisaged on certain agricultural, fish and marine products so as to ensure a sufficient degree of reciprocity to members heavily depending on the export of these products. Time-table for the removal of trade barriers in the Stockholm Convention has been so designed as to facilitate the re-opening of negotiations between the EEC and EFTA for closer economic arrangements.

At the beginning of the Sixteenth Session, the Contracting Parties set up a Working Party to examine the provisions of the Stockholm Convention in the light of the relevant provisions of the
General Agreement. A number of issues were raised in the Working Party. Firstly, sub-paragraph 8(b) of Article XXIV requires the constituent territories of a free trade area to eliminate duties and other restrictive regulations of commerce on "substantially all trade" between themselves. It was held that the Stockholm Convention did not fulfil this requirement because the provisions of the convention relating to the elimination of trade barriers in the free trade area did not apply to trade in agricultural products. (28) It was contended that the phrase "substantially all the trade" had a qualitative as well as quantitative aspect. The requirements of the sub-paragraph 8(b) of Article XXIV, therefore, would not be met so long as agriculture, an important sector of the economy, remained excluded. The Members agreed to the view that the quantitative aspect was not the only consideration to be taken into account. They, however, argued that the Convention did not exclude the agricultural sector from the free trade area. The agricultural agreements, which formed an integral part of the Convention, would considerably facilitate the expansion of trade in agricultural products. It was, however, held in the Working Party that sub-paragraph 8(b) of Article XXIV required elimination of barriers on substantially all the trade "between the constituent territories." Expansion of trade through bilateral agreements, therefore, could be counted only if the elimination of duties and other restrictive regulations of commerce was generalised to the trade of all Members.

As the bilateral agreements did not provide for elimination of barriers by all Members, the expansion of trade brought through

these could not be counted towards the requirements of sub-
paragraph 8(b) of Article XXIV. The Members, on the other hand,
contended that the bilateral agricultural agreements were an integral
part of the free trade area arrangements and in so far as these
provided for the complete elimination of barriers for certain
channels of trade, the trade liberated through these should be taken
into consideration. Further the phrase in Article XXIV is
"substantially all trade" and not "trade in substantially all
products." This indicated that the Agreement gave some latitude
to a member in respect of certain products.

A second issue related to the quantitative restrictions. (29)
The Members held that under Article XXIV they were entitled to remove
quantitative restrictions among themselves at a faster rate than
against third countries. They stated that though they were determined
to follow liberal trade policies, they were not prepared to forego
their rights obtained under Article XXIV. On the other hand,
certain members of the Working Party held that the Article XXIV in
no way affected the obligations of the contracting parties forming
a free trade area to apply quantitative restrictions in a non-
discriminatory manner.

The third issue related to bilateral agreements on agricultural
products. (30) It was held that the bilateral agreements were
incompatible with the provisions of Article XXIV because in most
of the cases the tariffs were removed only by one member state.
These could be compatible with the relevant provisions of the
General Agreement only if the reduced tariffs were extended to all

(29) Ibid., 75-9.
(30) Ibid., 80-3.
contracting parties or if all the member states removed tariffs on
the same products and thus included these in the free trade area.

At the Seventeenth Session, the Contracting Parties reached
the conclusion that there remained certain legal and practical
issues which could not fruitfully be discussed at that stage. (31)
The Contracting Parties, therefore, did not think it appropriate
to make recommendations to the parties to the Convention pursuant
to paragraph 7(b) of Article XXIV. They further agreed to furnish
in Article XXII consultations information regarding measures arising
out of the application of the Convention.

Free-trade Area between Nicaragua and El Salvador. A Treaty
between Nicaragua and El Salvador for the establishment of free
trade area was concluded in March 1951 and made effective in August
1951. At the request of the Nicaragua Government, the Contracting
Parties decided that the said country was entitled under Article
XXIV, paragraph 10 to enter into an agreement for the formation of
the free trade area. (32)

The Government of Nicaragua expressed its intention of
limiting the action under the treaty and particularly under
Article III and IV thereof to those consistent with the objectives
of maintaining a free-trade area as defined in Article XXIV,
paragraph 8(b) of the General Agreement and undertook to furnish
the Contracting Parties an annual report on action taken pursuant
to Articles III and IV of the said treaty and such additional
information as would be of help to the Contracting Parties. The

(31) Ibid., 201.
(32) GATT, n. 27, 30.
Contracting Parties reserved the right to review the decision in case the study of the reports submitted by the Government of Nicaragua and other relevant data leads them to the conclusion that the operation of the Free-Trade Treaty is not resulting in the maintenance of a free-trade area in the sense of Article XXIV of the General Agreement.

In taking the above decision two important questions were involved. Firstly, paragraph 5 of Article XXIV contemplates customs unions or free trade areas between the territories of contracting parties while El Salvador was not a contracting party. Secondly, Article III of the treaty envisaged the imposition of quantitative restrictions in certain cases which was contrary to the paragraph 8(a). In spite of these two conflicts, the Contracting parties approved the proposals considering that the Treaty was substantially in accordance with the provisions of the General Agreement.

Latin American Free Trade Association. With a view to strengthening their economies, rationalising their productive facilities, raising standards of living and improving their competitive position vis-a-vis other regional groupings, seven Latin American countries - Brazil, Chile, Peru, Uruguay, Argentina, Mexico and Paraguay - signed, in February 1960, a treaty in Montevideo establishing the Latin American Free Trade Association. Shortly afterwards the Treaty was submitted to the Contracting Parties. The Contracting Parties concluded that at this stage there remained certain legal and practical questions which could not be decided solely on the basis of the text of the Treaty and
could be more fruitfully discussed in the light of the actual working of the Treaty. (33)

Regional Groupings of Developing Countries

Regional groupings of developing countries can make an important contribution to their economic development. At the Second Session of the Preparatory Committee of the United Nations Conference on Trade and Development held in Geneva from 21 May to 29 June 1963, there was a general recognition of the benefits which regional economic groupings of the developing countries could have on their economic development and their foreign trade. Speaking at the World Conference on Trade and Developing, Mr. George D. Woods, President of the World Bank said:

For small countries with population of less than 5 million - that is two-thirds of the developing countries - the hope for satisfactory development lies largely in regional arrangements to eliminate trade barriers, enlarge markets and rationalise production among themselves. (34)

But it is difficult to form regional groupings among underdeveloped countries which conform to free trade areas or customs unions as required under Article XXIV of the GATT.

It is not mere chance that these (customs unions and free trade areas) (35) are organisations of established industrialised countries - it is these countries which are sufficiently advanced politically to be able to co-operate economically. Similar attempts at creating customs unions or free trade areas by less developed countries, as for example the Central American Free Trade Area or the Latin American Free Trade Area have not met with same measure of success. (36)

(33) GATT, n. 28, 21-2.
(34) The Economic Weekly (Bombay, 9 May 1964) 817.
(35) Words within parenthesis added.
what is possible among the developing countries is a loose sort of co-operation covering products of interest to them.

Article XXIV, 8 provides that Customs Union or Free Trade Area must cover 'substantially all the trade between the constituent territories.' As indicated, such an ambitious conception has so far been found possible only by advanced countries. It could be suggested therefore that among less developed countries a Customs Union or a regional organisation should cover certain products of interest to trade between these countries whether or not these products add up to substantially all the trade. In other words, what is suggested is that less developed countries should be permitted to form a partial Free Trade Area on those products in which at this stage they find it feasible to do so. (37)

Article 15 of the Havana Charter envisaged this sort of arrangement.

Advocating the case for special concessions to developing countries for liberalising trade among themselves, Professor Linder states:

The alternative to liberal trade among under-developed countries is not liberal trade with industrialised countries as well, but restrictive trade with everybody. (38)

(37) Ibid., 18.

(38) Staffow B. Linder, The Significance of GATT for Underdeveloped Countries, UN Economic Conference on Trade and Development Document No. T/CONF. 46/P/6 (January 1964) 75.