



University of Pretoria

Challenges Confronting the Establishment of A SADC Customs Union

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## Can SACU Lead The Process?

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SADC adopted the RISDP in 2003 which envisages the establishment of a customs union by 2010. What role can SACU play in the establishment of a SADC customs union?

**CHALLENGES CONFRONTING THE ESTABLISHMENT OF A SADC  
CUSTOMS UNION:  
CAN SACU LEAD THE PROCESS?**

**By**

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## Undertaking

“I undertake that all material presented for examination is my own work and has not been written for me, in whole or in part, by any other person(s). I also undertake that any quotation or paraphrase from published or unpublished work of another person has been fully acknowledged in the work which I present for examination”.

Siyabonga Sizwe Gcayi

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## TABLE OF CONTENTS

<b>Abbreviations and Acronyms</b>	<b>7</b>
<b>Summary</b>	<b>9</b>
<b>1. Introduction</b>	<b>10</b>
1.1 The Problem	12
1.2 Thesis Statement and Research Questions	13
1.3 Significance of the Study	13
1.4 Preliminary Literature Review	14
1.5 Research Methodology	15
1.6 Overview of Chapters	16
1.7 Delineations and Limitations of the Study	16
<b>2. Regional Integration under the Multilateral Trading System's Regulatory Framework</b>	<b>17</b>
2.1 The Relationship between RTA and WTO Rules	19
2.2 Scope of GATT Exception for RTA's: Article XXIV:5	20
(A) Exception as Defence	20
(B) Purpose of the Exception	21
2.3 GATT Article XXIV Exceptions	22
1. RTA'S Covered	22
(a) Customs Union and Free Trade Areas	22
(b) Interim Agreements	23
2. Measures Covered	24
(a) Measures adopted upon formation	24
(b) Measures Necessary for Formation	25
2.4 Eliminating Restrictions on Trade Within the RTA	27
I. Article XXIV:8(a)(i) and (b)	27
II. Measuring Substantially All the Trade	28
(a) Mixed Views	28
(b) Interpretation in Dispute Settlements	30
III. Eliminating 'Duties and Other Restrictive Regulations of Commerce'	31
IV. Application of Trade Remedies against RTA Partners	33
2.5 Article V of GATS	37
I. 'Substantial Sectoral Coverage' Requirement	38
II. 'Substantially all Discrimination' requirement	39

<b>III. 'Barriers to Trade' Requirement</b>	<b>40</b>
<b>2.6 Procedural Requirements of Article XXIV of the GATT and Article V of the GATS</b>	
<b>41</b>	
<b>3. How can SADC Member States harmonise their Divergent Trade Policies?</b>	<b>43</b>
<b>3.1 Rationale for a SADC Customs Union</b>	<b>45</b>
<b>3.2 GATT Article XXIV: 5(a)</b>	<b>47</b>
<b>3.3 Challenges in Harmonising SADC Countries Trade Policies</b>	<b>49</b>
<b>(a) The Common External Tariff</b>	<b>49</b>
<b>(b) Revenue Challenge</b>	<b>52</b>
<b>(c) The Challenge of Overlapping Membership</b>	<b>53</b>
<b>4. Which is a More Feasible arrangement for a SADC Customs Union: Dismantling SACU or Expanding SACU?</b>	<b>54</b>
<b>4.1 Brief Overview of SACU 1919-2002</b>	<b>54</b>
<b>a) 1969 SACU Agreement</b>	<b>55</b>
<b>4.2 The 2002 SACU Agreement</b>	<b>56</b>
<b>a) Governance of the Customs Union</b>	<b>56</b>
<b>b) Economic Policy Issues</b>	<b>57</b>
<b>c) External Trade Relations</b>	<b>57</b>
<b>d) Revenue Sharing</b>	<b>58</b>
<b>I. Customs Component</b>	<b>59</b>
<b>II. The Excise Component</b>	<b>59</b>
<b>III. Development component</b>	<b>59</b>
<b>4.3 Expanding SACU</b>	<b>59</b>
<b>4.4 Dismantling SACU</b>	<b>61</b>
<b>5. Conclusion</b>	<b>62</b>
<b>6. Bibliography</b>	<b>65</b>

## **Abbreviations and Acronyms**

<b>AB</b>	<b>Appellate Body</b>
<b>AU</b>	<b>African Union</b>
<b>AEC</b>	<b>African Economic Community</b>
<b>ANC</b>	<b>African National Congress</b>
<b>BLNS</b>	<b>Botswana, Lesotho, Namibia and Swaziland</b>
<b>CET</b>	<b>Common External Tariff</b>
<b>COMESA</b>	<b>Common Market for East and Southern Africa</b>
<b>CRTA</b>	<b>Committee on Regional Trade Agreements</b>
<b>DNA</b>	<b>Development Network Africa</b>
<b>EAC</b>	<b>East African Community</b>
<b>EU</b>	<b>European Union</b>
<b>FTA</b>	<b>Free Trade Area</b>
<b>GATT</b>	<b>General Agreement on Tariffs and Trade</b>
<b>GATS</b>	<b>General Agreement on Trade in Services</b>
<b>MFN</b>	<b>Most Favoured Nation</b>
<b>NAFTA</b>	<b>North American Free Trade Area</b>
<b>NIPF</b>	<b>National Industrial Policy Framework</b>
<b>TPRM</b>	<b>Trade Policy Review Mechanism</b>
<b>PAC</b>	<b>Pan Africanist Congress</b>
<b>PTA</b>	<b>Preferential Trade Area</b>
<b>RISDP</b>	<b>Regional Indicative Strategic Development Plan</b>
<b>RSF</b>	<b>Revenue Sharing Formula</b>

<b>SACU</b>	<b>Southern African Customs Union</b>
<b>SADC</b>	<b>Southern African Development Community</b>
<b>SADCC</b>	<b>Southern African Development Co-ordination Conference</b>
<b>TDCA</b>	<b>Trade and Development Co-operation Agreement</b>
<b>TRIPS</b>	<b>Trade Related Aspects of Intellectual Property</b>



## Summary

Regional integration is to progress to an advanced and critical stage in SADC. With the launch of the SADC free trade area having taken place successfully in 2008 the next step according to the SADC RISDP is the customs union stage. This stage involves deeper integration as well as more cooperation amongst Member countries and to some extent will involve ceding of sovereignty to a supranational body that will be tasked with the administration of the customs union. With the lack of cooperation that was showed by some SADC countries during the implementation of the SADC FTA one doubts whether SADC countries will indeed cooperate during the customs union phase. Different levels of development, divergent trade policies and overlapping membership into other RECs pose a significant challenge into the formation of a SADC customs union. Looking at the challenges confronting the formation of the SADC customs union it would seem as if it is all gloom and doom. However one lesson picked up in all regional integration initiatives in all regions of the world is that significant challenges will always exist; what is important is that Member countries need to show full commitment and focus on the bigger goal they seek to achieve as the region. SACU the world's oldest customs union is constituted by SADC Member countries. With the problem of overlapping membership SACU is both an obstacle and a solution for SADC depending on which view one holds. SACU can be seen as an obstacle because if SACU was not there perhaps the problem of overlapping membership would not be the way it is. Currently only one SADC country is not affected by the problem of overlapping into various other RECs. If SACU was not there the number of countries not overlapping would be perhaps six countries. On the other hand one can choose to look at SACU as a solution to the establishment of the SADC customs union under the circumstances that currently prevail in SADC. SACU can be used as a basis for a SADC customs union by having all other SADC Member that are ready to join the customs union accede into SACU and whilst others that are not ready still work on their policies and join latter when they are ready to do so. This is referred to as 'variable-geometry'; a principle that has been successfully implemented in the EU over the years. However taking a close look at SACU one realises that there is still lot of work to be done within SACU to have SACU ready for expansion.

## 1. Introduction

The concept of regional integration is not a new one in Southern Africa,<sup>1</sup> considering the fact that the Southern African Customs Union (SACU), the world's oldest customs union established in 1910 is constituted by Member States from Southern Africa.<sup>2</sup> SACU was originally established by an agreement between the Union of South Africa and three so-called British Commission Territories of Bechuanaland (Botswana), Basutoland (Lesotho) and Swaziland.<sup>3</sup> Ever since its establishment SACU has always been perceived as politically incorrect,<sup>4</sup> that is supported by the fact that besides its founding members' only one member state has acceded to the SACU agreement and that is Namibia.<sup>5</sup> Most countries in Africa and largely in Southern Africa perceived SACU as a project of apartheid South Africa that was politically and economically dominated by South Africa.<sup>6</sup>

Acknowledging South Africa's economic dominance in the region, Heads of States of various countries in the region got together to form the Southern African Development Co-ordination Conference (SADCC)<sup>7</sup>. At the heart of the organisation was the desire to reduce economic dependence on South Africa and to promote economic development.<sup>8</sup> SADCC was later on reconstituted as the Southern African Development Community (SADC).<sup>9</sup> The organisation would later play a crucial role in the fight against apartheid in South Africa by supporting liberation movements such as the African National Congress (ANC) and the Pan Africanist Congress (PAC). It is these relations with liberation movements that would later make South Africa to be easily admitted into SADC after South Africa adopted a new constitutional dispensation. There had been some debates in academic circles about which

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<sup>1</sup> C Grant 'Southern Africa and the European Union: the TDCA and the SADC EPA' (2006) 1.

<sup>2</sup> Southern African Customs Union (SACU) Agreement 1910. Some literature suggests that the origins of SACU can be traced back to the 1889 Customs Union Convention signed by the British Colony of the Cape of Good Hope and the Orange Free State Boer Republic. In 1893, British Bechuanaland (Botswana), and Basutoland (Lesotho), both under the direct administrative control of the British High Commissioner, joined the 1889 Customs Union Convention, albeit with significantly diminished rights. Although a second Customs Convention was negotiated in 1898, the Anglo-Boer war resulted in British colonial rule throughout the present day South Africa, Bechuanaland, Basutoland Swaziland and Rhodesians (Zambia and Zimbabwe). This made negotiating a customs union less onerous and in 1903 a customs union convention was signed between the Cape, Natal, Orange River Colony, Transvaal and Southern Rhodesia. Again Bechuanaland, Basutoland and Swaziland were admitted as members under a protocol, effectively categorising them as second class members with diminished rights. The formation of the Union of South Africa just seven years later resulted in the termination of all previous union arrangements. However, because the Union excluded the High Commission Territories, a new customs union agreement was reached in June 1910. Unpublished: S Ettinger: The Economics of the Customs Union between Botswana, Lesotho and Swaziland Unpublished PHD Thesis, University of Michigan 1974) as cited by R Gibb 'Regional Integration in Post-Apartheid Southern Africa: The case of Renegotiation of the Southern African Customs Union, Journal of Southern African Studies,' (1997) 23 NO 1, 73.

<sup>3</sup> C McCarthy: SACU at the Cross-Roads page 1.

<sup>4</sup> C Ng'ong'ola 'Regional Integration and Trade Liberalisation in the Southern African Development Community' Journal of International Economic Law (2000) 490.

<sup>5</sup> Namibia joined SACU after getting independence in her own right in 1990.

<sup>6</sup> C Ng'ong'ola (n 4 above) 487.

<sup>7</sup> C Ng'ong'ola (n 4 above) 487.

<sup>8</sup> C Ng'ong'ola (n 4 above) 487.

<sup>9</sup> C Ng'ong'ola (n 4 above) 487.

regional integration organisation would South Africa join after the new constitutional dispensation with some academics having suggested that South Africa would join the Common Market for East and Southern Africa ( COMESA) because COMESA was more economic orientated than SADC.<sup>10</sup> With South Africa having joined SADC the perception about SADC changed in the academic debate with some academics describing SADC as one regional integration arrangement with prospects of successful integration.<sup>11</sup>

South Africa joined SADC on the 24<sup>th</sup> of August 1994 and it was not long after South Africa's accession to the regional body; SADC then concluded the SADC trade protocol in Maseru, Lesotho on the 29<sup>th</sup> of August 1996.<sup>12</sup> This time fortuitously enabled the framing of the protocol to take into account the results and the changes to the multilateral trading system arising from the establishment of the World Trade Organisation (WTO) in 1995.<sup>13</sup> The protocol was signed by eleven member states of SADC at that time, excluding Angola. It reportedly entered into force on 25 January 2000 after ratification by at least two thirds of the member states.<sup>14</sup> Difficult and protracted negotiations on actual tariff reductions and implementation modalities accounted for the delay of the entry into force of the protocol.<sup>15</sup> In 2008 the protocol was however fully implemented by the majority of the member states. The SADC free trade area was formally launched on the 17<sup>th</sup> of August 2008.<sup>16</sup>

At the time that the SADC Trade Protocol was concluded in 1996 there was no indicative plan on SADC's approach to regional integration. It was only in 2003 at the SADC Heads of States' extra-ordinary summit in Windhoek Namibia where the Regional Indicative Strategic Development Plan (RISDP) was adopted. The SADC RISDP has extended its vision of integration beyond the level of integration envisaged by the protocol on trade. In terms of the RISDP SADC would become a Free Trade Area (FTA) by 2008, this has already been achieved with the SADC FTA having been officially launched on the 17 of August 2008.<sup>17</sup> The RISDP also envisages the establishment of SADC Customs Union by 2010, Common Market by 2015, Monetary Union by 2016 and Economic Union in 2018.

Regional integration in Southern Africa must be understood in the context of the vision of the African Economic Community (AEC). There has always been a debate about rationalizing regional integration in Africa. It is in that context that an African Union (AU) ministerial level conference addressing regional integration issues sat in Burkina Faso from 30-31 March 2006. The conference was to discuss and identify regional bodies that were to be considered

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<sup>10</sup> C Ng'ong'ola (n 4 above) 486.

<sup>11</sup> R Gibb 'Southern Africa in Transition, Prospects and Problems Facing Regional Integration, The Journal of Modern African Studies' Vol 38 NO 2 (1998) 292.

<sup>12</sup> C Ng'ong'ola (n 4 above) 495.

<sup>13</sup> C Ng'ong'ola (n 4 above) 495.

<sup>14</sup> C Ng'ong'ola (n 4 above) 495.

<sup>15</sup> C Ng'ong'ola (n 4 above) 495.

<sup>16</sup> Booklet Guide to the SADC protocol on trade page (2009) 1.

<sup>17</sup> An audit conducted by the Southern African Trade Hub/ Services group that was commissioned by the SADC secretariat found that four member states-Malawi, Mozambique, Zimbabwe and Tanzania- were not up to date in implementing their tariff phase down schedules and that Non-SACU members heavily back loaded their phase-down offers, similarly, trade facilitation instruments were not being implemented and non tariff barriers remained a serious barrier to trade.

as building blocks towards the AEC. It is in that conference where SADC was designated as a building block in the south overlooking SACU the oldest regional economic community in the world.

### 1.1 The Problem

As already indicated above in terms of the SADC RISDP, SADC is to become a customs union by 2010. It is well known that the problem of overlapping membership into regional economic communities is most prevalent in Southern Africa, with all countries except Mozambique, being members to more than one regional economic community.<sup>18</sup> The problem of overlapping membership poses a serious challenge for the progress in many regional economic communities and that may hinder the realisation of an AEC. In principle there is nothing that prevents a country from being a member of many regional economic arrangements, however if the regional economic arrangements are to proceed to the level of a customs union serious legal complications may arise.<sup>19</sup> The main problem would be the Common External Tariff (CET) that has to be applied by members of a customs union to third parties. If a country is to be a member of two customs unions the problem that would confront that particular country would be; which CET will it apply?

A customs union leads to a relatively deeper level of integration that requires governments to cede sovereignty on certain matters pertaining to trade and industrial policy. The disparities in levels of development amongst SADC economies will pose difficulties in the process of harmonising tariff policies. The rationale for tariff policies seems to be at variance amongst SADC countries. Some SADC countries (such as SACU member states) use tariffs as an instrument of industrial policy to protect their sensitive industrial sectors and others (such as Mauritius) use tariffs as a vehicle for their integration into the global economy; whilst the majority use tariff as a revenue-generating instrument for public budgetary purposes.<sup>20</sup>

Some SADC member states are also members of SACU and they have not indicated any intention of abandoning SACU for a SADC customs union. SACU's tariff policies are very important to support South Africa's industrial policies and as for the majority of other SACU countries SACU is an important revenue pool.<sup>21</sup>

### 1.2 Thesis Statement and Research Questions

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<sup>18</sup> P Elango & P Kalenga 'Whither the SADC Customs Union?' in A Bosl et al (eds) Monitoring Regional In Southern Africa Integration Yearbook: Tralac (2007) 8.

<sup>19</sup> P Elango & P Kalenga 'Whither the SADC Customs Union?' in A Bosl et al Monitoring Regional In Southern Africa Integration Yearbook (n 18 above) 8.

<sup>20</sup> P Elango & P Kalenga 'Whither the SADC Customs Union?' in A Bosl et al Monitoring Regional In Southern Africa Integration Yearbook (n 18 above) 8.

<sup>21</sup> R Davies's Speech at the 5<sup>th</sup> Celebrations of the existence of the International Trade Administration Commission (2008) 8.[http://www.itac.org.za/docs/rob-davies-notes-5<sup>th</sup>-iversary-16oct2008.pdf](http://www.itac.org.za/docs/rob-davies-notes-5th-iversary-16oct2008.pdf)(Accessed 04/12/2009)

In this study it will be argued that using SACU as a building block for a SADC customs union is more realistic and could improve the prospects of having a prosperous SADC customs union. SACU is an institutionally coherent and economically integrated group in Southern Africa which must be expanded to integrate more countries in the region. SACU must work towards developing clear accession criteria to be used to admit new members to the organisation

The main question that this study seeks to answer is: Can SACU be used to drive the formation of a SADC customs union?

In answering the main question, the following are to be answered to shed more light:

- (a) What is the legal framework for establishing a customs union under WTO law?
- (b) How can SADC member states harmonise their divergent trade policies?
- (c) Which is a more feasible arrangement for a SADC customs union: dismantling SACU or expanding SACU?

### 1.3 Significance of the study

This study is relevant not only to SADC and SACU which are directly affected by the anticipated formation of a SADC customs union but also to the academia.

For SADC and SACU the study offers them an opportunity to take some of the recommendations that will be proposed in this study when moving towards the formation of a SADC customs union.

For the academia this study is relevant to the ongoing debate about rationalising regional integration in Africa. Many scholars have written about regional integration in Southern Africa and of late they seem to paint a gloomy picture over prospects of a successful regional integration in Southern Africa. However this study will highlight amongst other issues that the most successful regional integration arrangement in the world today, which is the European Union (EU), was not an overnight success.

### 1.4 Preliminary Literature review

Academic writing on the appropriate route for a SADC customs union has not yet gained momentum. Regional Integration in Southern Africa has been a matter that has attracted great academic interest; however, very few scholars have tackled the customs union matter.

Literature on SACU is characterised by its highly politicised and often very biased nature.<sup>22</sup> Almost without exception, this literature focuses upon the regional context of the union, reflecting interests in an agreement between apartheid South Africa and ignores a wider perspective of regionalism and its relationship with the multilateral trading system.<sup>23</sup>

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<sup>22</sup> C Ng'ong'ola (n 4 above) this observation has also been made by R Gibb (n 2 above) 68.

<sup>23</sup> R Gibb (n 2 above) page 68.

Some scholars who have attempted to write about the appropriate route for a SADC customs union have suggested that SADC must use SACU and build on SACU by expanding SACU.<sup>24</sup> They base their argument on the principle of variable geometry. In terms of variable geometry, differentiated integration is pursued whereby countries join when they have already undergone the adjustment process taking into consideration the aspect of asymmetry in development.<sup>25</sup> In SADC with SACU as a nucleus of the new SADC customs union, the five current SACU members will automatically qualify based on their similar policies such as macroeconomic convergence, the common external tariff and other policies inherent in customs union.<sup>26</sup>

Some scholars are opposed to the idea of using SACU as a building block for a SADC customs union.<sup>27</sup> These scholars do not oppose the principle of variable geometry as the principle which must be used to guide the process. Their opposition to using SACU as a nucleus for a SADC customs union is based on their criticism of issues such as SACU's revenue sharing formula, and SACU's tariff policies and the SACU tariff structure.

In terms of the SACU revenue sharing formula, South Africa subsidises the share that the BLNS countries receive from the common revenue pool. A study conducted by the Development Network Africa (DNA) evaluating the appropriate model for a SADC customs union showed that the current revenue sharing formula could not be sustainable in a customs union that would include all SADC member states.<sup>28</sup> The study also revealed that the current revenue sharing formula also creates trade diversion to South Africa.<sup>29</sup> SACU member states that import more from other SACU members get an increased share from the common revenue pool and most of the time SACU members import from South Africa.<sup>30</sup>

Some scholars have also heavily criticised SACU's tariff policies. Professor Edwards and Professor Lawrence are some of the scholars who are critiques of SACU's tariff policies. They argue that the tariff structure that South Africa (and SACU) inherited from the apartheid era was defective in at least five counts. First, reflecting the import-substitution orientation of the government it was extremely protectionist. Second the structure was both complex and opaque. There were over 200 different rates and tariffs took a number of forms: ad valorem, specific, mixed, compound prices. Third, SACU decision-making process, South Africa unilaterally determined tariffs, while other SACU members were forced to simply fall

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<sup>24</sup> Unpublished: IM Rathumbu: Regional Integration and Economic Development in Southern Africa, Unpublished Master's Thesis University of South Africa (2008) 144. P Draper et al 'SACU, Regional Integration and the Overlap Issue in Southern Africa: From Spaghetti to Cannelloni?' Trade Policy Report NO.15 SAIIA (2007) 8. P Elango & P Kalenga (n 18 above) 13. Jakobeit et al 'Overlapping Membership in COMESA, EAC, SACU and SADC Trade Policy Options for the Region and for EPA Negotiations, Trade Matters' GTZ (2005) 171, Commissioned by Federal Ministry for Economic Cooperation and Development.

<sup>25</sup> IM Rathumbu (n 24 above) 144.

<sup>26</sup> IM Rathumbu (n 24 above) 171.

<sup>27</sup> F Flatters & M Stern: SACU Revenue Sharing: Issues and Options, Policy Brief Commissioned by the SACU Secretariat and USAID (2006)2. L Edwards and R Lawrence 'SACU Tariff Policies: Where should they go from here?' Harvard University CID Working Paper NO.169 (2008) 5. Development Network Africa: Evaluation of an Appropriate Model for a SADC Customs Union (2007) Study Commissioned by the SADC Secretariat.

<sup>28</sup> DNA (27 above) 7.

<sup>29</sup> DNA (27 above) 9.

<sup>30</sup> DNA (n 27 above) 9.

in line. Fourth, the arrangements for sharing revenues while relatively generous to other SACU members were problematic because they committed South Africa to pay amounts that did not reflect the actual tariff revenue generated and in fact payments could have eventually turned out to be greater than the tariff revenues actually received. And finally, since apartheid, South Africa, as a pariah state, was not a feasible partner, the arrangement presented structure problems for SACU in its relationship with other trading partners.<sup>31</sup>

Clearly scholars have acknowledged that SACU can be used as a building block for a SADC customs union. However in so doing some scholars have indicated that there are critical reforms required to be made in SACU if SACU is to be expanded.

### **1.5 Research Methodology**

The approach in this study would be descriptive, analytical, comparative and prescriptive. The descriptive approach would be employed because there will be an overview of the existing legislative and institutional framework in SADC and SACU. The analytical approach would be employed to evaluate the current legislative and institutional framework of SACU and whether under its current form it can be expanded to accommodate other SADC member states which are not members of SACU. A comparative approach would be used to determine ways that other regional economic communities that are customs union, have employed to move to the customs union level. Lastly the prescriptive approach will be used at the end in the form of recommendations aimed at encouraging SADC member states on how to trend carefully to the next stage of regional integration, which is the customs union level, which is a very critical stage for regional integration in Southern Africa.

Furthermore, intensive library research and literature based review will be employed. The primary sources of information will include (a) SACU Agreement 2002 (b) SADC Trade Protocol and Amended Trade Protocol (c) General Agreement on Tariffs and Trade 1994 (d) The Ankara Agreement 1963 (e) WTO Case Law.

The secondary sources will include (a) books (b) relevant journal articles (c) study reports on the appropriate model for a SADC customs union (d) papers written by academics and researchers on issues relevant to the study (e) speeches and daily newspapers containing information relevant to the issues and discussion.

### **1.6 Overview of Chapters**

#### **Chapter 2**

##### **Regional Integration under the Multilateral Trading System's Regulatory Framework**

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<sup>31</sup> Edwards & Lawrence (n 27 above) 3.

This chapter will give an in depth analysis of WTO law regulating regional integration. It will also look take an in-depth analysis on some of the most contentious concepts in GATT Article XXIV. It will also look at GATS V, the counterpart of GATT Article XXIV as well as procedural requirements affecting GATT Article XXIV, GATS Article V.

### **Chapter 3**

#### **How can SADC Member States harmonise their divergent trade policies?**

Noting the importance of harmonising trade policies when establishing a customs union this chapter will analyse the challenges confronting SADC member states when it comes to harmonising their divergent trade policies. It will also look at the question of coming up with a common external tariff and the tariff policies of some SADC countries.

### **Chapter 4**

#### **Which is a more feasible arrangement for a SADC customs union: dismantling or expanding SACU?**

Acknowledging the existing customs union in Southern Africa (SACU); this chapter will look at the question of whether to dismantle or expand SACU. It will look at the political as well as the economic considerations for any arrangement and most importantly the legal framework under which any arrangement would be done.

### **Chapter 5**

#### **Conclusion**

In the conclusion, recommendations will be offered on the appropriate route to be followed when SADC moves to the customs union level.

#### **1.7 Delineations and limitation of the study**

In terms of delineations, this study is only relevant to the period starting from 2003 when the SADC RISDP was adopted at the SADC extra-ordinary summit in 2003. Although regional integration has always been part of almost all SADC members states foreign policy, the defined framework for SADC integration was adopted in 2003. It is also important to point out that this study will not be assessing the prospects of meeting the 2010 deadline. This study will focus on legal issues that must be addressed in order to establish a WTO compliant customs union bearing in mind the economic conditions of various SADC member states.

In terms of limitations, there are inherent obstacles with regard to accessibility of some research material especially from internet sources. It is also important to acknowledge that this is a foreign policy matter for all governments of SADC member states. At the time of writing no government from SADC had indicated their position on the matter.

## **2. Regional Integration under the Multilateral Trading System's Regulatory Framework**



The global trading system is now comprised of an inter-locking, ever growing, network of regional and multilateral trade agreements.<sup>32</sup> A core objective of the multilateral trading system is 'the elimination of discriminatory treatment in international trade relations'.<sup>33</sup>

The multilateral trading system under the WTO is a rules and principled based trading system. Under WTO agreements, countries normally, cannot discriminate between their trading partners, (Most Favoured Nation (MFN) principle).<sup>34</sup>This principle is so important that it is contained in the first Article of the General Agreement on Tariffs and Trade (GATT), which governs trade in goods. MFN is also a priority in General Agreement on Trade in Services GATS (Article 2) and the Agreement on Trade Related Aspects of Intellectual Property (TRIPS) (Article 4), although in each agreement the agreement is handled slightly differently. Together those three agreements cover all three areas of trade handled by the WTO. Some exceptions are allowed.<sup>35</sup>

Regional Trade Agreements (RTAs) are an exception to WTO rules. GATT Article XXIV allows RTAs covering trade in goods as one of the few legal exceptions to the basic MFN principle of non-discrimination; Article V of GATS allows a similar exception for RTAs covering trade in services. In addition to this so-called enabling clause (the 1979 decision on differential and more favourable treatment, reciprocity and fuller participation of developing countries) allows preferential trade arrangements in trade in goods between developing country members of the WTO. This paper will be looking at RTAs covered by Article XXIV of GATT particularly a customs union.<sup>36</sup>

In order to have a better appreciation of the rules on regional integration, it is necessary to take a brief look at the various levels of regional integration and how the rules relate to the various types of regional integration arrangements. RTA is a very general term that could refer to a whole range of different levels of economic integration. At the first or lowest level we find Preferential Trade Agreements (PTA), normally concluded at a bilateral level, countries use these to liberalise trade in specific products or sectors and these agreements are therefore very limited.<sup>37</sup>

As indicated above, developing countries are allowed under the enabling clause to enter into regional or global preferential trade arrangements for trade in goods. The enabling clause therefore covers not only preferential trade agreements, but also other agreements

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<sup>32</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT 1994: An Exception and its Limits' in AD Mitchell (eds) *Challenges and Prospects for the WTO* (2005) 219.

<sup>33</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above)

<sup>34</sup> WTO handbook 'Understanding the WTO' (2008) 10.

<sup>35</sup> WTO handbook (n 42 above) 10.

<sup>36</sup> C Jakobeit et al (n 24 above) 45.

<sup>37</sup> C Jakobeit et al (n 24 above) 46.

such as Free Trade Areas. It however only applies to agreements between developing countries.<sup>38</sup>

Other RTAs covering trade in goods have to comply with various requirements set out in Article XXIV. Article XXIV (4) contains a general requirement that FTAs and customs unions must facilitate trade between the constituent territories and not raise barriers to trade between other parties and these territories. Article XXIV (5) (b) allows the formation of FTAs or interim agreements leading to the formation of a FTA, provided that duties and other regulations of commerce imposed by the constituent territories on trade with WTO members not party to the FTA or interim agreement at the time of establishing the FTA are no higher than before the formation of the FTA or interim agreement. In this type of RTA members remove all barriers to internal trade within the FTA, but they retain their individual external tariffs.<sup>39</sup> Examples of FTAs include the bilateral TDCA between the EU and SA, the SADC FTA under the SADC Trade Protocol and the COMESA FTA.<sup>40</sup>

As the external tariff differs from one member of a FTA to another, detailed rules of origin need to be included in these agreements in order to prevent transshipment and to ensure that only countries that are party to the agreement benefit from the preferences provided by it. If it were not for these rules third countries would simply tranship their products duty free through the FTA member with the lowest external tariff to those with higher tariffs. As rules of origin can prescribe a certain percentage of local content or local value added, it can be effectively used as a non-tariff barrier to trade and often leads to trade diversion. This means that rules of origin are often used for protectionism, but unfortunately there are no WTO rules regulating the use of rules of origin.<sup>41</sup>

The next step in deepening integration is the establishment of a customs union. In a customs union we also have free movement of goods between members as in a FTA; but it goes further as it requires members of to adopt a common external tariff. Members therefore need to have the same external trade policy.<sup>42</sup> Similarly to the case of FTAs Article XXIV(5)(a) allows the formation of a customs union as long as duties and other regulations of commerce imposed at the establishment of any such union or agreement are not higher or more restrictive than prior to the establishment of such a union or the adoption of such interim agreement.<sup>43</sup>

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<sup>38</sup> C Jakobeit et al (n 24 above) 46.

<sup>39</sup> C Jakobeit et al (n 24 above) 46.

<sup>40</sup> C Jakobeit et al (n 24 above) 46.

<sup>41</sup> C Jakobeit et al (n 24 above) 46.

<sup>42</sup> C Jakobeit et al (n 24 above) 47.

<sup>43</sup> C Jakobeit et al (n 24 above) 47.

GATT Article XXIV (5) (c) furthermore requires interim agreements, FTAs and CU's to be established within a reasonable length of time.<sup>44</sup> Another requirement is that both an FTA and a CU, the elimination of tariffs and other regulations of commerce must be "on substantially all trade".<sup>45</sup>

## 2.1 The Relationship between RTA and WTO Rules

The general rule is that in international law there is no hierarchy among treaties; with the well known exception being the supremacy of the Charter of the United Nations over any other international treaty as expressly provided for in Article 103 of the Charter.<sup>46</sup> One would then argue that in the event of conflict between any rule of the WTO and a RTA (both of which belong to the category of international treaties), there is no clear cut hierarchy among them, and accordingly their relationship would be determined in light of Article 30 of the Vienna Convention.<sup>47</sup> However the fallacy in this approach of resorting to Article 30 and according similar status to RTA and WTO rules would be evident if one takes into account the provision of Article 41 (1) of the Vienna Convention.<sup>48</sup> As both Article XXIV of the GATT and Article V of the GATS plainly allow the execution of international treaties in the form of customs unions and free trade agreements by virtue of Article 41(1) of the Vienna Convention, the latter kind of treaties could modify the provisions only in the former only if it is allowed by the former.<sup>49</sup> Therefore the argument is tenable that Article 41 (1) implies the WTO rules are inherently of higher rank than RTAs. In other words, RTAs are subservient

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<sup>44</sup> GATT Article XXIV (5) (c).

<sup>45</sup> Further discussion follows below.

<sup>46</sup> Charter of the United Nations and Vienna Convention on the Law of Treaties. MD R Islam and S Alam 'Preferential Trade Agreements and the Scope of GATT Article XXIV, GATS Article V and the Enabling Clause: An Appraisal of GATT WTO Jurisprudence: Netherlands International Review' (2009) 4.

<sup>47</sup> Article 30 of the Convention Reads as Follows:

- 1) Subject to Article 103 of the Charter of the United Nations, the rights and obligations of State parties to successive treaties relating to the same subject matter shall be determined in accordance with the following paragraphs:
- 2) When a treaty specifies that it is subject to, or that it is not to be considered as incompatible with, an earlier or later treaty, the provisions of the other treaty prevail.
- 3) When all parties to the earlier treaty are parties also to the later treaty but the earlier treaty is not terminated or suspended in operation under article 59, the earlier treaty applies only to the extent that its provisions are compatible with those of the latter treaty.
- 4) When the parties to the latter treaty do not include all the parties to the earlier one:
  - a) As between States parties to both treaties the same rules apply in paragraph 3;
  - b) As between a State to both treaties and a State party to only one of the treaties, the treaty to which both States are parties governs their mutual rights and obligations
- 5) Paragraph 4 is without prejudice article 41, or to any question to the termination or suspension of the operation of a treaty under article 60 or to any question of responsibility which may arise for a State from the conclusion or application of a treaty the provisions of which are incompatible with its towards another state under another treaty.

<sup>48</sup> MD. R Islam & S Alam (n 46 above) 4.

<sup>49</sup> MD R Islam & S Alam (n 46 above) 4.

to the rules of the WTO in the same manner as ordinary legislation of parliament in a domestic legal context would be to the provisions of the constitution.<sup>50</sup>

## 2.2 Scope of the GATT Exception for RTAs: Article XXIV: 5

### (A) Exception as Defence

Article XXIV: 5 of GATT 1994 provides an exception to certain WTO obligations for ‘customs unions’ and ‘free-trade areas’, which are two possible types of RTAs for the purposes of this paper. The opening paragraph or chapeau, of Article XXIV: 5 states:

Accordingly, the provisions of this Agreement shall not prevent, as between the territories of Members, the formation of a customs union or of a free-trade area...<sup>51</sup>

The Appellate Body has indicated that the words ‘shall not prevent’ in Article XXIV: 5 mean that the provisions of the GATT 1994 shall not make impossible the formation of a customs union<sup>52</sup> or, presumably, an FTA.<sup>53</sup> That is, Article XXIV: 5 provides a justification for the adoption of certain RTA’s and constitutes a ‘defence’ to a claim that such an RTA is inconsistent with any provision of GATT 1994.<sup>54</sup> According to the general jurisprudence of WTO panels and the Appellate Body regarding the burden of proof in WTO disputes, this means that it would be for the WTO Member challenging an RTA to establish inconsistency with a provision of GATT 1994, and for the responding Member to prove the inconsistency is justified or removed<sup>55</sup> because the RTA falls within the exception in Article XXIV: 5.<sup>56</sup>

### (B) Purpose of the Exception

The WTO Agreements, including GATT 1994, are to be interpreted according to the words used in the treaty, read in context, and in the light of the object and purpose of the

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<sup>50</sup> MD R Islam & S Alam (n 46 above) 4.

<sup>51</sup> Article XXIV: 5 of GATT 1994.

<sup>52</sup> Appellate Body Report, Turkey-Textiles, para 45(original emphasis), as cited by NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell 40 above page 221.

<sup>53</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 21. In Turkey Textiles, the Appellate Body was considering a customs union and not an FTA. However, the chapeau of Article XXIV: 5 applies to both customs unions (under Article XXIV: 5(a)) and FTA’s (under Article XXV: 5(b)), so the same reading of the words ‘shall not prevent, should also apply to FTA’s.

<sup>54</sup> Appellate Body Report, Turkey-Textiles, para 45 as cited by NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 221.

<sup>55</sup> Appellate Body Report, EC – Tariff Preferences, 100-103.

<sup>56</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (32 40 above) 221.

treaty.<sup>57</sup> Article XXV: 4 sets out the purpose of the exception in Article XXIV: 5 and therefore acts as a guide to understanding and applying that exception.<sup>58</sup> Article XXIV: 4 states:

“The Members recognise the desirability of increasing freedom of trade by the development, through voluntary agreements, of closer integration between the economies of countries parties to such agreements. They also recognise that the purpose of a customs union or a free-trade area shall be to facilitate trade between the constituent territories and not to raise barriers to the trade of other members with such territories.”<sup>59</sup>

This statement is complemented by the Understanding on the Interpretation of Article XXIV of GATT 1994 (RTA Understanding), in which WTO Members expand further on the purpose of Article XXIV: 5. In the RTA Understanding, WTO members:

- recognise ‘the contribution of the expansion of world trade’ that maybe through the establishment of customs unions and FTAs;
- recognise that the expansion of world trade ‘is increased’ if internal trade restrictions within an RTA are eliminated for ‘all trade’ and ‘diminished if any major sector of trade is excluded’; and
- reiterate that the establishment of an RTA ‘should to the greatest extent possible avoid creating adverse effects on the trade of other Members’.<sup>60</sup>

In *Turkey – Textiles*, the Appellate Body addressed Article XXIV for the first time. The Appellate Body noted that Article XXIV: 4 does not set forth a separate obligation itself but, rather, sets forth the overriding and pervasive purpose for Article XXIV.<sup>61</sup> It Added that the other provisions of Article XXIV must be interpreted in the light of the purpose’ through a process of ‘constant reference to this purpose.’<sup>62</sup>

One can therefore conclude that the purpose of the RTA exception, as reflected in Article XXIV: 4 and the RTA Understanding, is the promotion of trade. As noted earlier, the parties to an RTA grant each other special trade preferences that are not offered to other WTO members.<sup>63</sup> The establishment of an RTA, therefore, creates the potential for positive effects on internal trade between the parties (who benefit from the trade preferences) and

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<sup>57</sup> NJS Lockhart and AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 40 above 221 Article 3.2 of the DSU states that the WTO agreements are to be interpreted in accordance with customary rules of interpretation of public international law. These rules were codified in Articles 31 and 32 of the Vienna Convention on the Law of Treaties, opened for signature 23 May 1969, 1155 (entered into force 27 January 1980): Appellate Body Report, *US-Gasoline*, 17.

<sup>58</sup> NJS Lockhart and AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 221.

<sup>59</sup> GATT Article XXIV: 4.

<sup>60</sup> RTA Understanding Preamble.

<sup>61</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 222.

<sup>62</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 222.

<sup>63</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 222.

negative effects on external trade with other members (who are excluded from the preferences). To ensure an overall expansion of world trade, the exception in Article XXIV: 5 is designed to maximise the internal trade liberalising effects of an RTA and to minimise its external trade-restricting effects.<sup>64</sup>

## 2.3 GATT Article XXIV Exceptions

### 1 RTAs Covered

#### (a) Customs Union and Free Trade Areas

The exception in Article XXIV: 5 of GATT 1994 apply to customs unions and FTAs, as defined in Article XXIV: 8(a) and (b) respectively. Broadly, a customs union means ‘the substitution of a single customs territory for two or more customs territories, so that almost all restrictions are eliminated with respect to substantially all trade between the parties (that is internal trade), and the parties apply substantially the same restrictions to the trade or other countries (that is, external trade).<sup>65</sup> It is a type of trade bloc which is composed of a free trade area with a common external tariff.<sup>66</sup> The participant countries set up common external trade policy, but in some cases they use different import quotas. It is the third stage of economic integration. Again in broad terms, An FTA is a group of two or more customs territories in which almost all restrictions are eliminated with respect to substantially all internal trade.<sup>67</sup>

In essence Article XXIV: 8 establishes conditions with which an agreement must comply in order to fall within the definition of a customs union or an FTA.<sup>68</sup> In addition Article XXIV: 5 describes certain conditions that a customs union or an FTA must meet in order to benefit from the exception.<sup>69</sup> The conditions imposed on customs unions and FTAs are similar in many respects, as discussed further below.

Many WTO agreements have special rules or flexibilities that apply less onerous disciplines to developing countries as compared to developed countries (an aspect of ‘special and differential treatment’).<sup>70</sup> In the context of RTAs, a less onerous definition could have applied to a customs union or an FTA between a developing country WTO Member and a developed country WTO Member.<sup>71</sup> For instance, in forming an FTA, a developing country could have been permitted to liberalise its own market to a lesser degree than a developed country

<sup>64</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 222.

<sup>65</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 223.

<sup>66</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 223.

<sup>67</sup> NJS Lockhart & AD Mitchell ‘Regional Trade agreements under GATT’ in AD Mitchell (n 32 above) 223.

<sup>68</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 223.

<sup>69</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 223.

<sup>70</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 223.

<sup>71</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 223.

partner (so-called 'asymmetrical' obligations). However the exceptions in Article XXIV: 5 do not expressly include any such flexibility.<sup>72</sup>

*(b) Interim Agreements*

The formation of an RTA entails significant trade policy coordination among the parties, as well as extensive changes to domestic regulations affecting trade.<sup>73</sup> Article XXIV recognises that WTO Members wishing to enter into an RTA may not be able to achieve the required level of economic integration immediately.<sup>74</sup> Consequently, the exception for RTAs in Article XXIV: 5 extends to 'interim agreements' necessary for the formation of customs unions or FTAs, subject to certain agreements, must lead to the formation of a customs union or FTA 'within a reasonable length of time'.<sup>75</sup> Paragraph 3 of the RTA Understanding specifies that this period should exceed 10 years only in exceptional cases. Although such cases are not defined, where one of the RTA parties is a developing country, the level of development of that party might be an exceptional circumstance justifying an extended period of time for formation of an RTA.<sup>76</sup>

There is some controversy as to when an interim agreement must meet the requirements of Article XXIV: 5 and 8. Some Members consider that these requirements need to be fulfilled only at the end of the reasonable period of implementation.<sup>77</sup> Others argue that the requirements of Article XXIV: 5 (not raising external barriers to trade) must be met at all stages of implementation.<sup>78</sup> The distinction seems to find support in textual differences between the two paragraphs. Article XXIV: 5 explicitly includes 'interim agreements' in the list of agreements that may impose higher or more restrictive external trade restrictions. In contrast, Article XXIV: 8 does not state that 'interim agreements' are subject to the requirement to eliminate internal restrictions on substantially all trade.<sup>79</sup> This suggests that interim agreements need not fulfil the requirements of paragraph 8 but must fulfil the requirements of paragraph 5. This reading of the text is consistent with the purpose of the RTA exception because it ensures that other WTO Members are not faced with increased

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<sup>72</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 223.

<sup>73</sup> MD R Islam & S Alam (n 46 above 19): They explain that the execution of a PTA is a tedious process that demands a degree of change to domestic regulations affecting trade (the degree of variation depending on whether it is CU or FTA) coupled with significant trade policy synchronisation among the executing states.

<sup>74</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 224.

<sup>75</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 224.

<sup>76</sup> R Scollay "'Substantially All Trade": Which Definitions are fulfilled in Practice? An Empirical Investigation: A Report for the Common Wealth Secretariat (2005) 16.

<sup>77</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 224.

<sup>78</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 224.

<sup>79</sup> R Scollay (n 76 above) 13.

barriers to trade at any stage of the implementation process but it allows Members time to eliminate internal trade restrictions.<sup>80</sup>

## 2 Measures Covered

### (a) Measures Adopted Upon Formation

Article XXIV: 5 states that GATT 1994 shall not prevent the formation of a customs union or a free-trade area. The Appellate Body interpreted the word ‘formation’ to mean that measures imposed by WTO Members that would otherwise be inconsistent with GATT 1994 do not fall within Article XXIV: 5 exception unless they are ‘introduced upon the formation of a customs union’ or, presumably, an FTA. Thus, WTO-inconsistent measures that are added to the terms of an RTA after the RTA has been formed would not fall within the exception.<sup>81</sup>

In some situations, this limitation may create difficulties for RTA parties. One example arose in *US – Line Pipe* in relation to safeguard measures, which are emergency actions taken to respond to particular market situations on a temporary basis.<sup>82</sup> The dispute in *US – Line Pipe* concerned a specific safeguard measure on line pipe adopted by the United States. The United States excluded imports from Canada and Mexico from the application of the safeguard measure because these three countries had agreed as a general matter, pursuant to the North American Free Trade Agreement (NAFTA), not to impose safeguard measures on each other. Korea challenged the safeguard under several provisions of GATT 1994 because the mechanism and the Agreement on Safeguards.<sup>83</sup> The panel found that the line pipe measure fell within the exception of Article XXIV: 5 of GATT 1994 because the mechanism providing for the exclusion of free-trade area partners from safeguard measures was established upon the formation of the North American Free Trade Agreement (NAFTA), even though the specific safeguard on line pipe was adopted after NAFTA’s formation.<sup>84</sup> On appeal the Appellate Body found it unnecessary to review these findings and declared them to be ‘moot’ and of no legal effect. Therefore although the Panel’s reasoning is instructive, it has no formal legal value.<sup>85</sup>

The Panel’s approach adds a dose of pragmatism to the understanding of the word ‘formation’ in Article XXIV: 5. Often, the parties to a customs union or an FTA will be unable to provide specifically for every conceivable eventuality upon the formation of the

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<sup>80</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 224.

<sup>81</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 224.

<sup>82</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 225.

<sup>83</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 225.

<sup>84</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 225.

<sup>85</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 225.



agreement.<sup>86</sup> Therefore a distinction should be drawn between general framework provisions introduced upon formation and specific implementation measures adopted subsequently pursuant to the framework provisions.<sup>87</sup> The exception under Article XXIV: 5 should extend to the framework provisions and the implementing measures. However, to improve transparency and to allow WTO Members to scrutinise an RTA at the time of its adoption, the framework provisions should make plain the nature of the WTO-inconsistent measures envisaged and the circumstances in which they are likely to be adopted.<sup>88</sup>

*(b) Measures Necessary for Formation*

In *Turkey – Textiles*, the Appellate Body specified that Article XXIV:5 can be used as a defence for inconsistent measures adopted in connection with a customs union ‘only to the extent that the formation of the customs union would be prevented if the introduction of the measures were not allowed.’<sup>89</sup> Presumably this ‘necessity test’ would apply equally to FTAs. If applied broadly, this test would mean that an RTA can only depart from GATT 1994 rules if the departure is necessary to the formation of the RTA.<sup>90</sup>

However, it is not clear whether the necessity test applies solely to inconsistencies arising from the imposition of external trade restrictions or also to inconsistencies arising from the elimination of internal trade restrictions. Although the Appellate Body drew no distinction between these types of restrictions in formulating the test, that dispute concerned an inconsistency resulting from the introduction of restrictions on the external trade of a customs union.<sup>91</sup> In particular, Turkey introduced 19 quantitative restrictions on imports from India on the formation of a customs union with the European Union.

In *US – Line Pipe*, the Panel noted that specific facts addressed in *Turkey – Textiles* and suggested that the necessity test does not apply to inconsistencies arising from the elimination of internal trade restrictions. The Panel stated:

The elimination of ‘duties and other restrictive regulations of commerce’ between parties to a free-trade area...is the very *raison d’être* of any free-trade area. If the alleged violation of GATT 1994 forms part of the elimination of ‘duties and other restrictive regulations of commerce’, there can be no question of whether it is necessary for the elimination of ‘duties and other restrictive regulations of commerce’.<sup>92</sup>

<sup>86</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 225.

<sup>87</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 225.

<sup>88</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 226.

<sup>89</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 226.

<sup>90</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 226.

<sup>91</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 226.

<sup>92</sup> Panel Report *US – Line Pipe*, para 7.148.

On appeal in US – *Line Pipe*, the Appellate Body did not specifically address this finding, but it held that the Panel’s findings on Article XXIV were moot and had no legal effect.<sup>93</sup> Nonetheless, there are good reasons for confirming the Appellate Body’s ruling in *Turkey – Textiles* to the facts before it and, therefore, applying a necessity test only to the external trade restrictions.<sup>94</sup> This approach is inconsistent with the purpose of the exception in Article XXIV: 5. As discussed above the exception in Article XXIV: 5 aims to prevent increases in the level of external trade restrictions.<sup>95</sup> Therefore it makes sense to impose an additional requirement of necessity on the introduction of any such restrictions. However, as reflected in the RTA Understanding, a key purpose of the exception in Article XXIV: 5 is to promote the complete elimination of internal trade restrictions. The application of a necessity test to internal trade restrictions would undermine this purpose by requiring RTA parties to demonstrate that the elimination of each and every internal restriction is necessary to the formation of the RTA.<sup>96</sup>

Moreover, as explained below, under Article XXIV: 8, the parties to an FTA are required only to eliminate internal restrictions on ‘substantially’ – but not all – trade. Therefore under, this provision, it is never necessary to eliminate all internal trade restrictions. The application of a necessity test in this situation, could, therefore, mean that parties would be required to maintain some internal restrictions.<sup>97</sup> Yet, the stated purpose of Article XXIV, as set out in the RTA Understanding, seeks precisely to secure the elimination of all internal trade restrictions. The application of the necessity test would, therefore, prevent parties to a customs union or an FTA achieving the objectives of Article XXIV.<sup>98</sup>

Moreover it is difficult to see how WTO Members, Panels, or the Appellate Body Could determine whether the elimination of a particular trade restriction among RTA parties was necessary for the formation of the RTA, or why they should have jurisdiction to review such questions. Article XXIV: 8 of GATT 1994 simply requires an RTA to eliminate trade restrictions on ‘substantially all’ internal trade.<sup>99</sup> It focuses on the level of internal trade restrictions rather than the type of trade affected.<sup>100</sup> It does not prescribe which restrictions should be removed and which maintained; nor does it provide criteria in this regard. Thus, the RTA parties have discretion as to which internal trade restrictions to eliminate and in which circumstances; provided that restrictions are eliminated on ‘substantially all trade’. It would go beyond the role of panels and the Appellate Body to second-guess such decisions.

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<sup>93</sup> Appellate Body Report, US – Line Pipe, paras 198-199.

<sup>94</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 226.

<sup>95</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 226.

<sup>96</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 226.

<sup>97</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 227.

<sup>98</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 227.

<sup>99</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 227.

<sup>100</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 227.

In addition, the panel in *US – Pipe Line* gave the following example of the practical difficulties of applying a necessity test to internal trade restrictions:

*“Assume that an FTA eliminates duties on peanuts, but not cars. In the context of a necessity test, third countries could claim that it was not necessary to eliminate duties on peanuts to meet the ‘substantially all the trade’ threshold of Article XXIV: 8(b), as that threshold could have been met by eliminating duties on cars. In such cases, it is difficult to imagine how a necessity requirement could ever be fulfilled.”<sup>101</sup>*

## 2.4 Eliminating Restrictions on Trade within the RTA:

### I. Article: XXIV: 8 (a) (i) and (b)

As already mentioned; Article XXIV: 8 of GATT 1994 defines ‘customs union’ and ‘free-trade area’. To benefit from the exception in Article XXIV: 5, an RTA must meet one of these definitions. Both types of RTAs are defined by the elimination of internal trade restrictions. For customs unions, this requirement is contained in Article XXIV: 8(a) (i):

duties and other restrictive regulations of commerce (except where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated with respect to substantially all trade between the constituent territories of the union or at least with respect to substantially all the trade in products originating in such territories....<sup>102</sup>

For FTAs, the corresponding requirement is contained in Article XXIV: 8 (b):

Duties and other restrictive regulations of commerce (except where necessary those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated on substantially all the trade between the constituent territories in products originating in such territories.<sup>103</sup>

Thus both customs unions and FTAs: (a) require the elimination of restrictions on ‘substantially all the trade’ between the RTA parties; (b) define the restrictions that must be eliminated as duties and ‘other restrictive regulations of commerce, (ORRCs); and (c) expressly allow the maintenance of certain restrictions, ‘where necessary’, namely ‘those permitted under Articles XI, XII, XIII, XIV, XV and XX of GATT 1994.’<sup>104</sup>

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<sup>101</sup> *Panel Report, US – Line Pipe, n 137.*

<sup>102</sup> GATT Article XXIV: 8.

<sup>103</sup> GATT Article XXIV: 8.

<sup>104</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 232.

Before turning to an examination of these three common elements, we point out a difference in these provisions regarding the origin of goods traded between RTA parties. In the case of customs unions, internal restrictions must be eliminated either on substantially all trade between the parties, or on substantially all trade in products originating in the parties. The first option is more trade liberalising, because it entails the elimination of restrictions on trade in any goods, irrespective of where the goods originate.<sup>105</sup> In contrast, the second option entails the elimination on trade only on goods originating within the customs union. In the case of FTAs, only the second of these options is available. That is, internal restrictions must be eliminated on substantially all trade ‘in products originating’ within the FTA.<sup>106</sup>

## II. Measuring ‘Substantially All the Trade’

### a) Mixed Views

The meaning of ‘substantially all the trade’ in Article XXIV: 8 has given rise to unprecedented debate in trade law corridors and academics over the years. To date, WTO Members have been unable to agree on the proportion of trade that amounts to ‘substantially’ all trade,<sup>107</sup> or how ‘all the trade within an RTA is to be measured.’<sup>108</sup> However, two overlapping approaches have gained currency. Firstly; a qualitative approach, which would require the elimination of restrictions with respect to every major sector of the economies of the RTA parties. Second, a quantitative approach, which relies on a statistical threshold, for example, is requiring the elimination of restrictions with respect to a predefined percentage of trade.<sup>109</sup>

The qualitative approach is designed to prevent RTA parties from maintaining restrictions to protect important sectors from competition within the RTA. The rationale would seem to be that an exception to WTO rules should only be granted when parties to a regional agreement have shown commitment to closer economic integration.<sup>110</sup> If the parties exclude major economic sectors from liberalisation, that commitment is deemed lacking. If this approach were adopted, it would be likely to operate in conjunction with a quantitative

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<sup>105</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 232.

<sup>106</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 232.

<sup>107</sup> New Zealand has even suggested, in view of the many difficulties surrounding the word ‘substantially’, that the word should be ‘removed’ from Article XXIV: 8: WTO Committee on Regional Trade Agreements, Note on the Meetings of 16-18 and 20 February 1998, WT/REG/M/16 (18 March 1998) para 115.

<sup>108</sup> See WTO Committee on Regional Trade Agreements, Coverage, Liberalisation Process and Transitional Provisions in Regional Trade Agreements: Background survey by the Secretariat, WT/REG/W/46 (5 April 2002)

<sup>109</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 233.

<sup>110</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 233.

criterion, and rules would be required to determine what constitutes a major economic sector.<sup>111</sup>

Under the quantitative approach, one suggestion is that internal restrictions should be eliminated on 95% of all Harmonised Commodity Description and Coding System (HS) tariff lines at six digit level. Tariff lines can be used as a criterion to ensure that liberalisation covers all possible or potential trade between the RTA parties, because all goods fall within a tariff line.<sup>112</sup> However using tariff lines may give a misleading impression of the extent to which trade has been liberalised, for instance, few actual trade flows between the RTA parties are concentrated in a few tariff lines.<sup>113</sup> If restrictions on these few tariff lines were maintained, a large share of current trade could escape liberalisation. Conversely, a large number of tariff lines may be devoted to a small amount of actual trade. For example, around a quarter of all HS tariff lines deal with agricultural products, this may account for only a small portion of actual trade.<sup>114</sup>

Trade flows provide an alternative to tariff lines in establishing the threshold of trade for which restrictions must be eliminated. Thus, for example, the elimination of internal restrictions could be required with respect 95% of all trade flows between the RTA parties. However using trade flows as a criterion is also problematic.<sup>115</sup> First, actual trade flows are distorted by trade restrictions and do not necessarily reflect the likely trade volumes if restrictions were eliminated. Second, difficulties arise in applying this criterion. For example, a threshold of 95% of all trade could be measured either as a proportion of aggregate trade flowing between the parties as a proportion of each party's individual trade with the other. To take the simplest case, where there are only two RTA parties, suppose that Country A exports to Country B are valued at R95 million, and Country B exports to Country A are valued at R 5 million. Using aggregate to measure, the two countries would need to eliminate internal trade restrictions on 95% of the total trade, valued at R100 million. The parties would have discretion as to which part of the total trade to liberalise, and they could even agree simply that Country B would eliminate all restrictions on country A imports. In contrast, using an individual measure, each country would have to eliminate trade restrictions on 95% of the imports from the other country.<sup>116</sup>

The question of how to calculate trade flows in applying a quantitative approach to 'substantially all the trade' could be of particular importance in the case of North-South agreements, where the parties may wish to liberalise trade unequally.<sup>117</sup> Using an

<sup>111</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 233.

<sup>112</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 234.

<sup>113</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 234.

<sup>114</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 234.

<sup>115</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 234.

<sup>116</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 234.

<sup>117</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 232.

aggregate, developing countries might be able to benefit from elimination of restrictions on a greater share of their exports to a developed country party.<sup>118</sup> Alternatively, WTO Members might consider it preferable to prescribe measurement, in order to prevent one RTA party from forcing another, in a weaker bargaining position, to accept a lower degree of liberalisation.<sup>119</sup>

In order to measure ‘substantially all trade’ between FTA parties ‘in products originating’ in those parties under Article XXIV: 8 (b), rules are required to determine whether goods ‘originated’ within the RTA. Such rules are also needed in connection with a customs union if the parties chose to eliminate restrictions not with respect to substantially all trade between them but only with respect to substantially all trade in products originating in the parties’ territories.<sup>120</sup>

Rules of origin are used to decide in which country goods are produced and, therefore, in an RTA setting, whether they qualify for a tariff preference. In FTAs, the parties often adopt special rules of origin to determine which goods qualify for preferential treatment in the RTA.<sup>121</sup> The preferential rules may apply much stricter qualifying conditions than the rules of origin generally used in MFN trade.<sup>122</sup> Thus, goods that are deemed to originate in one RTA party under the general rules of origin may not be treated as originating in that party under preferential rules of origin. Such special rules of origin may, therefore, narrow the scope of trade that is liberalised within an RTA.<sup>123</sup> This has led some Members to suggest that the measurement of ‘substantially all the trade’ should take into account preferential rules of origin. For example, all trade within an RTA in products originating in the RTA parties could be measured using MFN rules of origin, while the proportion that is liberalised could be measured using the preferential rules of origin applying within that RTA.<sup>124</sup>

## **b) Interpretation in Dispute Settlements**

Although WTO Members are yet to agree on the meaning of the term ‘substantially all the trade’, Panels or the Appellate Body may be called upon to interpret the term in dispute settlement. So far, neither the Appellate Body nor any panel has provided a detailed

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<sup>118</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 232.

<sup>119</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 232.

<sup>120</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 234.

<sup>121</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 234.

<sup>122</sup> Preferential rules of origin are not subject to the general obligations in the Agreement on Rules of Origin, although they are subject to certain transparency requirements in the Common Declaration with Regard to Preferential Rules of Origin in Annex II of that Agreement.

<sup>123</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 235.

<sup>124</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 235.

interpretation this notion.<sup>125</sup> In *Turkey – Textiles*, the Appellate Body noted that ‘substantially all the trade’ is not the same as all the trade, but it is something considerably more than merely some of the trade, therefore, the relevant amount of trade falls somewhere between some and all trade among the RTA parties. Beyond this, the disputes provide little guidance.<sup>126</sup> In order to prove that NAFTA complied with Article XXIV: 8(b) in *US – line Pipe*, the United States submitted evidence that NAFTA eliminated duties 97% of the Parties’ tariff lines, representing more than 99% of the trade among them in terms of volume.<sup>127</sup> After reviewing the evidence, and without offering any views on the meaning of ‘substantially all the trade’, the panel held that the United States had established a prima facie case that NAFTA met the definition of an FTA under Article XXIV: 8(b). The Appellate Body took the view that it need not address this finding and declared it to be of no legal effect.<sup>128</sup>

It is perhaps unrealistic and inappropriate to expect that panels or the Appellate Body will develop a refined formula for identifying ‘substantially all the trade’.<sup>129</sup> For instance, it would be difficult for a panel to find a textual basis for a finding that a precise threshold of 90% is never substantial but that a precise threshold of 95% always is. If the clarification of this notion is left to the panels and the Appellate Body, it is more likely that they will develop a flexible test premised on the word ‘substantial’, which indicates the elimination of internal restrictions must cover a considerable proportion of the trade between the parties.<sup>130</sup>

### III Eliminating ‘Duties and Other Restrictive Regulations of Commerce’

A second question from the definitions of customs unions and FTAs is which trade restrictions are to be eliminated; according to Article XXIV: 8(a) (i) and (b), the parties to a customs or an FTA must eliminate duties and ORRCs on substantially all the trade within the RTA.<sup>131</sup> WTO Members have frequently discussed the words ‘duties and other restrictive regulations of commerce’, without reaching any agreement on their meaning. Similarly, no panel or Appellate Body reports to date have interpreted these words.<sup>132</sup> While the words ‘substantially all the trade’ dictate how much trade must be liberalised within an RTA, the words ‘duties and other restrictive regulations of commerce’ describe the types of restrictions to be eliminated. Evidently, elimination of a broader range of restrictive

<sup>125</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 235.

<sup>126</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 235.

<sup>127</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 235.

<sup>128</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 236.

<sup>129</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 236.

<sup>130</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 236.

<sup>131</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 236.

<sup>132</sup> MD R Islam & S Alam (n 46 above) 16.

regulations will result in a higher level of liberalisation within the RTA, in accordance with the purpose of the exception in Article XXIV: 5.<sup>133</sup>

What seems important, in determining which regulations constitute ORRCs, is not the form of regulation, but its effect on commerce.<sup>134</sup> The requirement of elimination applies only to regulations that have a 'restrictive' effect on commerce, irrespective whether the regulation imposes duties or takes some other form. Article XXIV: 8 does not state expressly what kind of restrictive effect is intended.<sup>135</sup> Virtually all regulations affecting goods have some kind 'chilling' effect that restricts trade in those goods. This is equally true of border regulations, which chill imports, and market place regulations, which chill trade in domestic and imported goods.<sup>136</sup> It seems rather unlikely, though, that Article XXIV: 8 was intended to encompass all regulations that have a restrictive effect on trade, however small. It is worth noting that the RTA understanding refers to the 'elimination between the constituent territories of duties and other restrictive regulations of commerce.'<sup>137</sup> This suggests that the regulations to be eliminated under Article XXIV: 8 are those restricting the cross-border movement of goods between the RTA parties. The focus of internal liberalisation under Article XXIV: 8 is, in other words, on restrictions that adversely affect imported or exported goods, with the goal being to create a market among the parties that is border-free rather than regulation-free.<sup>138</sup>

So what types of restrictions are duties or ORRCs pursuant to Article XXIV: 8? By definition, border restrictions apply solely to imports imposing restrictions on the cross-border movement of goods, and they are certainly ORRCs.<sup>139</sup> These include import bans, quantitative restrictions, and the many administrative rules regulating importation. Sanitary and phytosanitary (SPS) measures prohibiting the importation of goods would also be ORRCs. ORRCs are likely to include marketplace regulations that adversely affect imported goods, as compared with domestic goods, but such regulations would likely be already proscribed by the WTO national treatment obligation.<sup>140</sup>

Much discussion among academics and WTO negotiators has focused on whether trade remedy measures are ORRCs.<sup>141</sup> Measures adopted under Article (anti-dumping and countervailing measures) or XIX (safeguard measures) of GATT 1994 are not expressly identified in the bracketed phrase in Article XXIV: 8, ('except, where necessary, those

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<sup>133</sup> MD R Islam & S Alam (note 46 above) 16.

<sup>134</sup> MD R Islam & S Alam (n 32 above) 16.

<sup>135</sup> MD. R Islam & S Alam (n 46 above) 16.

<sup>136</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 237.

<sup>137</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 237.

<sup>138</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 237.

<sup>139</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 237.

<sup>140</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 237.

<sup>141</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 237.



permitted under Articles XI, XII, XIII, XIV, XV and XX'). The exclusion of trade remedy measures from this phrase could mean that trade remedy measures are simply not ORRCs (in which case there was not to include them in the brackets and they are not subject to the elimination requirement).<sup>142</sup> However, it could also be that they are ORRCs and their exclusion from the brackets means there is no express right to maintain them (in which case they should be eliminated on substantially all trade between the RTA parties).<sup>143</sup>

The text of Article XXIV: 8 contains little support for excluding trade remedy measures from the measures that need to be eliminated, i.e. duties and ORRCs. Anti-dumping and countervailing duties are described as 'duties' in Articles II and VI of GATT 1994, as well as in the Anti-Dumping Agreement.<sup>144</sup> These 'duties' are imposed, in addition to ordinary customs duties, on the importation of products. Moreover, the very purpose of these duties is to restrict imports of specific products.<sup>145</sup> Under Article XIX of GATT 1994, safeguard measures involve the modification or withdrawal of a market access concession for imported goods. The purpose of safeguard measures is, therefore, also to restrict imports.<sup>146</sup> The restriction on access takes the form of either a duty or a quantitative restriction. Again, there is little reason to suppose that safeguards are not ORRCs.<sup>147</sup>

#### IV Application of Trade Remedies against RTA Partners

As noted above<sup>148</sup> the discussion of the concept 'other restrictive regulations of commerce' amongst academics has often revolved around trade remedies. For the purposes of this paper, the application of trade remedies against RTA partners is discussed separately.

There is a question to be determined as to whether remedial trade measures can be applied to a RTA partner. According to Article XXIV: 8 (a) and (b), parties to customs union or an FTA, must eliminate duties and 'other restrictive regulations of commerce' on substantially all trade' within the RTA.<sup>149</sup>

As noted in the discussion above,<sup>150</sup> there is ambiguity regarding the precise meaning of the phrase 'other restrictive regulations of commerce'. In particular, it is ambiguous whether

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<sup>142</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 237.

<sup>143</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 237.

<sup>144</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 237.

<sup>145</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 238.

<sup>146</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 238.

<sup>147</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 238.

<sup>148</sup> ORRCs discussed above at 2 B.

<sup>149</sup> MD R Islam & S Alam (n 46 above) 14.

<sup>150</sup> ORRCs discussed above at 2 B.

trade remedies such as antidumping duties, countervailing duties and safeguard measures can be applied to PTA partners, or they must be exempted from such measures.<sup>151</sup>

One fertile area of dispute over the scope of the RTA exception in Article XXIV: 5 concerns the Agreement on Safeguards. Safeguard measures are imposed by WTO Members pursuant to both Article XIX of GATT 1994 and the provisions of the Agreement on Safeguards. Articles I, XIII and XIX of GATT 1994, as well as Article 2.2 of the Agreement on Safeguards, require that safeguard measures be applied on a non-discriminatory, MFN basis to imports on the relevant product from all sources. In some instances a WTO Member has excluded RTA partner countries from the application of safeguard measures, claiming that such discriminatory application is permitted under Article XXIV. This situation may raise questions regarding the type of measures that benefit from the exception in Article XXIV: 5 as discussed above and the requirement in Article XXIV: 8 that RTAs eliminate internal trade restrictions on 'substantially all trade' as discussed above.<sup>152</sup>

Textually, Article XXIV: 8 states that tariffs and trade restrictions must be liberalised, but measures under Articles XI, XII, XIII, XIV, XV, and XX are exempted from the obligation to liberalise, and can obviously be maintained among the PTA members. If the Article is thought to be prescriptive, as safeguards or anti-dumping or countervailing measures are not included in the list, it can be interpreted that such measures fall beyond its scope and so cannot be applied to fellow RTA Members. In other words, the list is exhaustive and safeguard measures need to be abolished within the RTA Members. It can be further argued that if safeguard measures are used among PTA partners, the trade liberalisation by RTAs and Member countries' commitments for economic integration would be defeated or in any case compromised, and hence they must exempt their RTA partners from any safeguard action as soon as the RTA is fully implemented.<sup>153</sup>

On the other hand it can validly be argued that a narrow scope of listed provisions in the exception parenthesis of Article XXIV: 8 does signify the list is not exhaustive. For example, it would be hard to think that all trade restrictions imposed on the basis of national security exceptions under Article XXI must be eliminated between RTA parties.<sup>154</sup> Indeed, it seems implausible to argue that by reaching an agreement to establish a RTA, the parties would pledge their security would never be threatened by actions of their partners. Furthermore, safeguard measures are designed as tools to be resorted to in special circumstances by a Member of the WTO, who is facing serious injury to a domestic industry from increased

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<sup>151</sup> MD. R Islam & S Alam (n 46 above) 14.

<sup>152</sup> Discussion on the concept 'substantially all trade' above at 2.4 A.

<sup>153</sup> Australia's and Canada's arguments in Committee on Regional Trade Agreements, Communication from Australia, WTO Doc. WT/REG/W/18 (17 November 1997); WTO Doc. WT/REG/M/15; and WT/REG/W37.

<sup>154</sup> J Pauwelyn 'The Puzzle of WTO Safeguards and Regional Trade Agreements', 7 Journal of International Economic Law (2004) p. 109 at pp 126-127.

imports. So, if imports continue to flow from an RTA partner, it is bound to raise a question as to whether the injury in the first place is serious enough to warrant measures against third parties.<sup>155</sup>

In between the two extreme positions presented above there is also an inter-mediate position on the application safeguard measures among RTA partners, based on the volume of imports from the RTA partner. That, is whether the import consists of a 'substantial share' of total imports and contributes to the 'serious injury', the RTA parties may or may not be allowed to exempt their partners from global safeguard actions.<sup>156</sup> However, this immediate approach would not conform to the doctrine of parallelism applied by the Panel and Appellate Body, as the doctrine requires that when imports from a member is included in the investigation of injury, the safeguard measure must also apply to such imports.<sup>157</sup>

In *Argentina – Footwear Safeguards*<sup>158</sup>, in determining injury to a domestic injury, Argentina took into account the import of footwear from its fellow RTA State Parties to MERCOSUR, but excluded imports from them in the application of its safeguard measure. The EU challenged the legality of Argentina's action and the Panel did not accept Argentina's argument that by virtue of Article XXIV: 8 it was required not to apply safeguards to its fellow Members. The Panel found that practice of the contracting parties to the GATT of 1947 and of WTO Members is uncertain on the issue of imposition or maintenance of safeguard measures between the RTA partners, and whilst many RTAs permit Members to impose safeguard measures on intra-RTA trade, few RTAs explicitly proscribe the imposition of intra-regional safeguard measures.<sup>159</sup> The Panel's rejection of Argentina's exemption of MERCOSUR partners was based on the doctrine of parallelism.<sup>160</sup> That is, inclusion of FTA or CU partners in the analysis of imports in safeguards investigation requires that such partners also have to be included in the application of safeguard measure.<sup>161</sup> The Appellate Body ruled too that when a WTO Member performs an investigation on the basis of imports from all countries, it cannot exclude PTA partners from the application of its safeguard measures.<sup>162</sup>

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<sup>155</sup> Japan's and Hong Kong's arguments in Committee on Regional Trade Agreements, Note on the Meeting of 3-5 November 1997, WTO Doc. WT/REG/M/14 (24 November 1997); WT/REG/M/15 and WT/REG/W/37.

<sup>156</sup> Israel's and Canada's Arguments in Committee on Regional Trade Agreements, Examination of the Free Trade Agreement between Canada and Israel, Note on the Meeting of 20 June 1997, WTO. WT/REG31/M/1 (29 July 1997); Committee on Regional Trade Agreements, Examination of the Free Trade Agreement between Canada and Chile, Note on the Meeting of 7 May 1998, WT/REG38/M/1 (11 June 1998) and WT/REG/W/37.

<sup>157</sup> MD R Islam & S Alam (n 46 above) 16.

<sup>158</sup> *Argentina – Safeguard Measures on Imports of Footwear*, WTO Doc. WT/ DS121/R (1999), Report of the Panel.

<sup>159</sup> MD R Islam & S Alam (n 46 above) 16.

<sup>160</sup> MD R Islam & S Alam (n 46 above) 16.

<sup>161</sup> MD R Islam & S Alam (n 46 above) 16.

<sup>162</sup> MD R Islam & S Alam (n 46 above) 16.

In *United States – Line Pipe*, the Panel held that the United States’ exemption of its NAFTA partners, Canada and Mexico and the application of safeguard measures was not a violation of Article XIX of the GATT 1994 as Article XXIV of the GATT 1994 provided a justification for the United States exclusion of Canada and Mexico from the application of the safeguard measures at issue.<sup>163</sup> The Panel referred to the necessity test applied by the Appellate Body ruling in *Turkey – Textiles* but felt that the finding in that case was ‘conditioned by the facts of that case’.<sup>164</sup> In particular, in the Panel’s view, the necessity test is suitable if Members of a RTA want to impose new restrictive measures on imports from non-RTA partners upon the formation of the RTA.<sup>165</sup> However, it was of the view that taking such an approach is wrong in cases where any violation of GATT 1994 is with regard to the elimination of ‘duties and other restrictive regulations of commerce’ between parties to FTA (possibly the same would apply to a CU too), ‘which is the very rasion d’être of any FTA.’<sup>166</sup>

On appeal, the Appellate Body observed that the question whether or not Article XXIV can be applied as an exception to the requirement of non-discrimination under the GATT arises only in two situations, namely: (i) when the competent administering authority does not consider imports from countries within the RTA in determining serious injury and (ii) when the administering authority considers imports that are exempted from safeguard measure in their investigation and determines that imports coming from Members outside the RTA alone are sufficient to cause a serious injury to the domestic industry.<sup>167</sup> In other words, the Appellate Body refrained from ruling on the relation between Article XIX and XXIV.<sup>168</sup> It further observed that if there is any gap between the scope of imports covered under the investigation, and imports falling within the scope of imports covered under the investigation, and imports falling within the scope of the safeguard measure as a result of the investigation, the competent authority of the Member imposing the safeguard measure must explicitly show that imports outside the PTA alone caused or threatened to cause serious injury.<sup>169</sup> Such a claim must be established through a reasoned and adequate explanation of how the facts support such a determination.<sup>170</sup> It should further be added the Panel noted, in order to be qualified as explicit, a statement must express distinctly all that is meant; it must leave nothing merely implied or suggested, it must be clear and unambiguous’.<sup>171</sup>

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<sup>163</sup> MD R Islam & S Alam (n 46 above) 17.

<sup>164</sup> MD R Islam & S Alam (n 46 above) 17.

<sup>165</sup> MD R Islam & S Alam (n 46 above) 17.

<sup>166</sup> MD R Islam & S Alam (n 46 above) 17.

<sup>167</sup> MD R Islam & S Alam (n 46 above) 17.

<sup>168</sup> MD R Islam & S Alam (n 46 above) 17.

<sup>169</sup> MD R Islam & S Alam (n 46 above) 17.

<sup>170</sup> MD R Islam & S Alam (n 46 above) 17.

<sup>171</sup> MD R Islam & S Alam (n 46 above) 17.

The point of difference between the anti-dumping and countervailing measures and the safeguard measure is that Article 2.2 of the WTO Safeguard Agreement overtly mentions the non-discriminatory principle, anti-dumping and countervailing measures are inherently discriminatory, and its application is restricted specifically to the alleged exporters or countries.<sup>172</sup> Accordingly, there is an argument that the issue of MFN application does not come up in the application of Anti-dumping and countervailing measures.<sup>173</sup> There are few cases where parties to some RTAs use competition or anti-trust policy measures rather than applying anti-dumping measures, and some Members of the WTO view the maintenance of a dual system of anti-dumping duties for third parties and competition policy for RTA parties, as prone to the trade distorting.<sup>174</sup> Despite this concern, no rule has been framed in this regard.<sup>175</sup>

Article 3.3 of the WTO Anti-dumping Agreement and Article 15.3 of the WTO Subsidies and Countervailing Measures Agreement, permit 'accumulation' where imports of a product from more than one country are simultaneously subject to anti-dumping or anti-subsidy investigation, and the incumbent, investigating authorities could cumulatively evaluate the impact of such imports.<sup>176</sup> In such a case of cumulative, if imports from the RTA partners are included in the investigation of injury to the domestic injury, but exempt from the application of the remedial measure, the issue of 'parallelism' could also arise in the anti-dumping and countervailing measures to imports of a RTA partner has not yet been questioned before the WTO Panel or Appellate Body.<sup>177</sup>

In the disputes mentioned above, the Panel and the Appellate Body until now have evaded passing on any ruling that would directly decide the legality or otherwise of invoking Article XXIV as a defence for the non-application of safeguard measures on imports from RTA partners.<sup>178</sup> The disputed safeguard measures have been held to be inconsistent with the WTO rules in terms of the procedural issue of satisfying the requirement of parallelism.<sup>179</sup>

## 2.5 Article V of the GATS

Article V of GATS, entitled 'Economic Integration', is the counterpart of Article XXIV of the GATT 1994 for trade in services.<sup>180</sup> Article V:1 of GATS provides: This Agreement shall not prevent any of its Members from being part to or entering into an agreement liberalizing

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<sup>172</sup> MD R Islam & S Alam (n 46 above) 17.

<sup>173</sup> MD R Islam & S Alam (n 46 above) 17.

<sup>174</sup> Japan's argument in Committee on Regional Trade Agreements, Communication from Japan, WTO Doc. WT/REG/W/28 (28 July) 1998.

<sup>175</sup> MD R Islam & S Alam (n 46 above) 18.

<sup>176</sup> MD R Islam & S Alam (n 46 above) 18.

<sup>177</sup> MD R Islam & S Alam (n 46 above) 18.

<sup>178</sup> MD R Islam & S Alam (n 46 above) 18.

<sup>179</sup> MD R Islam & S Alam (n 46 above) 18.

<sup>180</sup> P Van Den Bossche: The Law and Policy of the WTO (2006) 662.

trade in services between or among the parties to such an agreement, provided that such agreement:

- a) has substantial sectoral coverage, and
- b) provides for the absence or elimination of substantially discrimination, in the sense of Article XVII, between or among parties, in the sectors covered under subparagraph (a) through:
  - i. elimination of existing discriminatory measures, and/ or
  - ii. prohibition of new or more discriminatory measures, either at the entry into force of that agreement or on the basis of a reasonable time-frame, except for measures permitted under Articles XI, XII, XIV and XIV *bis*.<sup>181</sup>

The Panel in *Canada-Autos* noted that: “Article V provides legal coverage for measures taken pursuant to economic integration agreements, which would otherwise be inconsistent with the MFN obligation in Article II.”<sup>182</sup>

It follows from Article V: 1 that a measure otherwise GATS-inconsistent is justified under Article V:

- if the measure is introduced as part of an agreement liberalising trade in services, that meets all the requirements set out in Article V: 1(a) (the substantial sectoral coverage requirement), Article V: 1 (b) the substantially all discrimination requirement) and Article V: 4 (the ‘barriers to trade’ requirement); and
- if WTO Members would be prevented from entering into such an agreement liberalising trade in services, if the measure concerned were not allowed.<sup>183</sup>

## 1) ‘Substantial sectoral coverage’ requirement

Pursuant to Article V: 1(a) of GATS, an economic integration agreement must have ‘substantial sectoral coverage’ of the trade in services among the parties to the agreement. The footnote to the provision states that ‘substantial sectoral coverage’ should be ‘understood in terms of the number of sectors, volume of trade affected by the modes of supply’.<sup>184</sup> The footnote also provides that an economic integration agreement may not *a priori* exclude any of the four modes of supply.<sup>185</sup> In particular, no economic integration

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<sup>181</sup> GATS Article V.

<sup>182</sup> Panel Report *Canada – Autos*, para. 10.271 as cited by P Van Den Bossche (n 180 above) 664 . *Canada – Autos* is the only case in WTO Jurisprudence that dealt with Article V of the GATS. MD R Islam & S Alam (46 above) 26.

<sup>183</sup> The Chapeau of Article V: I.

<sup>184</sup> P Van Den Bossche (n 180 above) 664.

<sup>185</sup> P Van Den Bossche (n 180 above) 664.

agreement should *a priori* exclude investment or labour mobility in the sense of modes 3 and 4.<sup>186</sup> Members disagree on whether one or more service sectors can be excluded from an economic integration but the use of the wording ‘number of sectors’ in the footnote to paragraph 1(a) seems to indicate that not all sectors must be covered under an economic integration agreement to meet the ‘substantial sectoral coverage’ test.<sup>187</sup> However, it is clear that the number of exclusions must be limited.<sup>188</sup> The Panel in *Canada – Autos* stated: “the purpose of Article V is to allow for ambitious liberalisation to take place at a regional level, while at the same time guarding against undermining the MFN obligation by engaging in *minor preferential arrangements*.”<sup>189</sup>

## 2) ‘Substantially all discrimination’ requirement

Article V: 1(b) of the GATS requires that an economic integration agreement should provide for the absence or elimination of substantially all discrimination.<sup>190</sup> As Article V: 1 (b) does not require the absence or elimination of all discrimination, but rather the absence or elimination of substantially all discrimination, the question arises as to what extent discriminatory measures should be allowed to exist in an economic integration agreement.<sup>191</sup> The scope of such permissible discriminatory measures is, of course, affected by the scope of the list of exceptions in Article V: 1(b). This list explicitly exceptions permitted under Articles XI, XII, XV and XV *bis* of the GATS, but it is unclear whether this list is exhaustive. The scope of permissible discriminatory measures is also affected by the meaning given to the ‘and/or’ wording in Article V: 1(b) linking provisions (i) and (ii).<sup>192</sup> Some Members are of the opinion that the ‘or’ allows the parties to an economic integration agreement to choose between provisions (i) and (ii), that is, the elimination of existing discriminatory measures, or alternatively, the use of a standstill.<sup>193</sup> A party could therefore choose to eliminate the possibility of adding new measures or of making existing measures more restrictive, rather than also having to eliminate existing measures. Other Members have rejected this interpretation.<sup>194</sup> They argue that, considering that Article V: 1 (b) aims to deal with ‘substantially all discrimination’, it would be appropriate to interpret the ‘and/or’ wording in such a way that both (i) and (ii) are found to be applicable. Thus it is argued that paragraphs (i) and

<sup>186</sup> P Van Den Bossche (n 180 above) 664.

<sup>187</sup> P Van Den Bossche (n 180 above) 664.

<sup>188</sup> P Van Den Bossche (n 180 above) 664.

<sup>189</sup> Panel Report, *Canada – Autos*, para. 10.271 as cited by See P Van Den Bossche (n 180 above) 664.

<sup>190</sup> P Van Den Bossche (n 180 above) 664.

<sup>191</sup> Article V: 6 of the GATS provides that a third-party service supplier, legally recognised as a juridical person by a party to an economic integration agreement, is entitled to equivalent treatment granted within the economic integration area, provided that it engages in ‘substantive business operations’ in the territory of the parties to that agreement. As cited by P Van Den Bossche (n 180 above) 664.

<sup>192</sup> P Van Den Bossche (n 180 above) 664.

<sup>193</sup> P Van Den Bossche (n 180 above) 664.

<sup>194</sup> P Van Den Bossche (n 180 above) 664.

(ii) are options to be judged as appropriate against the circumstances of the sector being considered, not as alternatives to be freely chosen by the parties to the economic integration agreement.<sup>195</sup> The Panel in *Canada – Autos* noted with respect to the obligation under Article V: 1(b): “Although the requirement of Article V: 1(b) is to provide non-discrimination in the sense of Article XVII (National Treatment), we consider that once it is fulfilled it would also ensure non-discrimination between all service suppliers of other parties to the economic integration agreement. It is our view that the object and purpose of this provision is to eliminate all discrimination among services and service suppliers of parties to economic integration agreement, including discrimination between the suppliers of other parties to an economic integration agreement.”<sup>196</sup>

According to the Panel, it would be inconsistent with Article V: 1(b) if a party to an economic integration agreement were to extend more favourable treatment to the service suppliers of one party than it does to service suppliers of another party to that agreement.<sup>197</sup> The concept of ‘a reasonable time frame’ in Article V: 1(b) is not defined or clarified in any way in the GATS.<sup>198</sup> On the basis of Article XXIV: 5(c) of the GATT 1994 and paragraph 3 of the Understanding on Article XXIV concerning the similar concept of a ‘reasonable length of time’, it would be reasonable to suppose that, in defining the ‘reasonable time frame’ of Article V: 1(b), a ten-year limit would be used as a general starting point.<sup>199</sup>

### 3) ‘Barriers to trade’ requirement

Article V: 4 requires that an economic integration agreement must be designed to facilitate trade between the parties to the agreement and must not, in respect of any Member outside the agreement, raise the overall level of barriers to trade in services within the respective sectors or subsectors compared to the level applicable prior to such an agreement.<sup>200</sup> The absence of detailed data on trade in services and differences in regulatory mechanisms between Members makes it difficult to evaluate the level of barriers in effect before the establishment of an economic integration agreement.<sup>201</sup> A possible approach to the application of this ‘barriers to trade’ requirement would be to require that an economic integration agreement reduce neither the level, nor the growth, of trade in any sector or subsector below a historical trend.<sup>202</sup>

## 2.6 Procedural Requirements of Article XXIV of the GATT and Article V of GATS

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<sup>195</sup> P Van Den Bossche (n 180 above) 664.

<sup>196</sup> Panel Report, *Canada – Autos*, para.10.270 as cited by P Van Den Bossche (n 180 above) page 665.

<sup>197</sup> P Van Den Bossche (n 180 above) 665.

<sup>198</sup> P Van Den Bossche (n 180 above) 665.

<sup>199</sup> P Van Den Bossche (n 180 above) 665.

<sup>200</sup> P Van Den Bossche (n 180 above) 665.

<sup>201</sup> P Van Den Bossche (n 180 above) 665.

<sup>202</sup> P Van Den Bossche (n 180 above) 665.



Any WTO member who decides to enter into a CU or FTA, or an interim agreement leading to the formation of a CU or FTA, is required to promptly notify other WTO members, and also make available to them such information regarding the proposed CU or FTA, as will enable them to make reports and recommendations as they deem fit.<sup>203</sup> It does not set down any specific notification format to be followed by countries wishing to form a RTA.<sup>204</sup> During the GATT years, a working party was established on a case by case basis to review the consistency of a notified RTA with the GATT rules.<sup>205</sup> In February 1996, The General Council of the WTO established the Communities on Regional Trade Agreements (CRTA) and it replaced the GATT working parties.<sup>206</sup> The obligation of the RTA Members to notify other members of the RTAs under Article XXIV is now carried out by notifying the Council for Trade in Goods, which adopts the terms of reference and transfers the RTA to the CRTA for examination.<sup>207</sup> The notification of agreements falling under the Enabling Clause is made to the Committee on Trade and Development (CTD), which holds debate on notified RTAs but generally asks for no in-depth examination in the CRTA.<sup>208</sup> RTAs covering trade in services concluded by WTO Members whether developed or developing, are notified to the Council for Trade in Services (CTS) which could decide to pass the RTA to the CRTA for examination, but unlike the case of PTA notified under Article XXIV of the GATT, such examination is only optional.<sup>209</sup>

At the Doha Ministerial Conference in 2001 the WTO Members agreed to launch negotiations in the area of WTO rules and provisions to RTAs were included in the Mandate.<sup>210</sup> Taking developmental aspects into account, the WTO members agreed to start negotiations that would improve disciplines and procedures under the existing WTO provisions applying to RTAs.<sup>211</sup> Then on 10 July 2006, negotiators of WTO's Doha Development Round approved a new WTO Transparency Mechanism for Regional Trade Agreements (Transparency Mechanism) and the WTO General Council formally established

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<sup>203</sup> Article XXIV: 7 of the GATT 1994 and Para 7 of the Understanding on the Interpretation of Article XXIV. Similar obligations also exist in Article V: 7 of the GATS and para 4 of the Enabling Clause as cited by MD R Islam & S Alam (n 46 above) 27.

<sup>204</sup> MD Islam & S Alam (n 46 above) 27.

<sup>205</sup> For a review of the GATT working party practice, see J. Huber, 'The Practice of GATT in Examining Regional Arrangements under Article XXIV', 19 *Journal of Common Market Studies* (1981) p.281 as cited by MD R Islam & S Alam (n 46 above) 27.

<sup>206</sup> Committee on Regional Trade Agreements, Decision of 6 February 1996, WTO Doc. WT/L/127 (February 1996) (Decision Establishing the CRTA).

<sup>207</sup> Work of the Committee on Regional Trade Agreements (CRTA), available at the WTO's website, [www.wto.org/english/tratop\\_e/region\\_e/regcom\\_e.htm](http://www.wto.org/english/tratop_e/region_e/regcom_e.htm) (accessed on 24 July 2008) as cited by MD R Islam & S Alam (n 61 above) 27.

<sup>208</sup> MD R Islam & S Alam (n 61 above) 27.

<sup>209</sup> MD R Islam & S Alam (n 61 above) 27.

<sup>210</sup> WTO Ministerial Declaration adopted on 14 November 2001. WTO Doc. WT/ MIN (01)/DEC/1(20 November 2001) (Doha Ministerial Declaration).

<sup>211</sup> MD R Islam & S Alam (n 61 above) 28.

the Mechanism on a provisional basis on 14 December 2006.<sup>212</sup> This Transparency Mechanism requires that notification of a RTA must be made as soon as possible and at least directly following the parties' ratification of it, and before the application of preferential treatment between the parties.<sup>213</sup> Once all parts of the agreement are notified to the WTO, it should start the examination process according to a precise timetable and generally be concluded within one year after the date of notification.<sup>214</sup> To facilitate the factual examination of the RTA by the CRTA, the Mechanism requires RTA Members to provide the CRTA with electronic versions of the Agreements within ten weeks or twenty weeks if the RTA involves only developing countries.<sup>215</sup> The Transparency Mechanism provides that in order to aid the WTO Members in their assessment of any notified PTA, the Secretariat, on its own responsibility, and in consultation with the parties, will prepare a factual presentation of the RTA.<sup>216</sup>

This procedure seems somewhat akin to what is prevalent in the WTO's Trade Policy Review Mechanism (TPRM), which also has the objective of ensuring the transparency of national trade policies.<sup>217</sup> If the TPRM can serve as precedent, it may be reasonable to expect the Secretariat's duty of reporting on PTAs, as introduced by the Transparency Mechanism, to ensure a degree of consistency in the assessment process, and could provide a better objective starting point for their assessment.<sup>218</sup> It is important to note that the Mechanism clearly spells out that the WTO's factual presentation on any notified RTA shall not be used as a basis for dispute settlement procedures or to create new rights and obligations for members.<sup>219</sup> It seems the aim of this provision is to encourage parties to a RTA to make full disclosure, but it is certain that a rule to the contrary would have helped the mechanism to be more meaningful.<sup>220</sup> The Transparency Mechanism also covers the post-implementation for all RTAs, and provides the required notification of changes affecting the implementation of any RTA, or the operation of an already implemented RTA, would be made as soon as possible.<sup>221</sup> With a view to tackle non-notification of PTAs, the Transparency Mechanism

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<sup>212</sup> WTO, Transparency Mechanism for Regional Trade Agreements, Decision of 14 December 2006, WTO Doc. WT/L/671 (18 December 2006) (Decision on Transparency Mechanism).

<sup>213</sup> MD R Islam & S Alam (n 61 above) 28.

<sup>214</sup> MD R Islam & S Alam (n 61 above) 28.

<sup>215</sup> MD R Islam & S Alam (n 46 above) 28.

<sup>216</sup> MD R Islam & S Alam (n 46 above) 28.

<sup>217</sup> Y Devuyt and A Serdarevic: 'The World Trade Organisation and Regional Trade Agreements: Bridging the Constitutional Credibility Gap', 18 *Duke Journal of International & Comparative Law* (2007) page 1 at para 48. For analysis of the Trade Policy Review Mechanism, see V Curzon Price, 'GATT's New Trade Policy Review Mechanism', 14 *World Economy* (1991) p. 227; PC Mavroidis, 'Surveillance Schemes: The GATT's New Trade Policy Review Mechanism', 13 *Michigan JIL* (1992) page 374 and S. Laird and P. Messerlin, 'Institutional Reform for Trade Liberalization', 13 *World Economy* (1990) page 230 as cited by MD R Islam & S Alam (n 46 above) 28.

<sup>218</sup> Devuyt and Serdarevic (note 217 above) page 49 as cited by MD R Islam & S Alam (n 46 above) 28.

<sup>219</sup> Transparency Mechanism, (n 212 above) as cited by MD R Islam & S Alam (n 46 above) 28.

<sup>220</sup> MD R Islam & S Alam (n 46 above) 28.

<sup>221</sup> MD R Islam & S Alam (n 46 above) 28.

provides that any Member of the WTO may at a time; bring to the attention of the relevant WTO body information on any RTA that in the opinion of that Member should have been submitted to members in the framework of the Transparency Mechanism.<sup>222</sup> The Transparency Mechanism is to be implemented on a provisional basis and WTO Members will review, modify and replace the provisional mechanism, as maybe needed with a permanent mechanism adopted as part of the overall results of the Doha Round.<sup>223</sup>

### 3. How can SADC Member States harmonise their divergent trade policies?

*“I have argued and I want to restate, that for us, tariff policy is fundamentally an instrument of industrial development, and needs to continue to be informed by sector level industrial strategies.....to be frank, historically the major interest of non South African Members of SACU has been in the revenue pool. The BLNS countries have not historically had any stake in industrial development in South Africa, except insofar as it has generated revenue to be shared through revenue sharing arrangements.”<sup>224</sup>*

With the launch of the SADC FTA having taken place in 2008, the next step of the SADC integration agenda is establishing a SADC customs union as envisaged in the SADC RISDP. The RISDP states that SADC will be a customs union in 2010,<sup>225</sup> however as indicated above for purposes of this paper, no discussion will focus on the prospects of meeting the 2010 deadline. So much has been written about SADC’s regional integration agenda and off lately there has been mounting criticism of SADC’s integration agenda with many scholars painting a gloomy picture over any prospects of a successful economic integration in SADC. Much of the criticism arises from the RISDP which took an ambitious view which failed to take into cognisance the vast levels of development of various SADC member states as well as divergent trade policies which would need much more time for harmonisation purposes than the RISDP currently affords.

According to the RISDP the next step of regional integration in SADC is the formation of a customs union which by its very nature will have major economic implications for various SADC Member States. The formation of a customs requires harmonisation of trade policies by member states to the customs union. With current prevailing circumstances in SADC, huge differences exist in terms of economic size, economic growth and development among

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<sup>222</sup> MD R Islam & S Alam (n 46 above) 28.

<sup>223</sup> MD R Islam & S Alam (n 46 above) 28.

<sup>224</sup> R Davies (n 21 above) 5.

<sup>225</sup> SADC RISDP.

SADC Member States.<sup>226</sup> These divergences pose significant challenges in the process of regional economic integration as envisaged in the RISDP.

Ever since independence, various African countries have always expressed ambitions of pursuing industrialisation; hence many countries have been very quick to sign up to many regional integration arrangements, because they saw such arrangements as an opportunity to pursue industrialisation as a broader regional market would obviously guarantee a market for the country's industrial produce. In the process of joining many RTA's SADC Member States further brought another dynamic in the regional integration agenda as multiple memberships to RTA's posse's significant challenges to the formation of a customs union.

Currently in SADC economies, the industrial structures of various SADC countries are highly diverse further complicating the harmonisation process.<sup>227</sup> Most SADC countries rely heavily on the production of primary products in agriculture and minerals, which are destined for exports to industrialised Western Countries.<sup>228</sup> The only two countries with significant manufacturing industries in SADC are South Africa and Mauritius. Divergent manufacturing sectors in SADC economies pose significant challenges for the setting of a common external tariff (CET) which is a key defining feature for a customs union.<sup>229</sup>

With South Africa and Mauritius being the most industrialised countries in the region, one would hope that the two countries would be best suited to lead the harmonisation process, however these two countries further complicate the harmonisation exercise as they use tariff polices for different purposes.<sup>230</sup> Mauritius has prioritised the growth of highly skilled services industry as the next stage of the country's development.<sup>231</sup> The country's trade policies focuses on improving trade competitiveness by overhauling the incentive framework, reducing distortion and biases and on turning Mauritius into a duty-free-island.<sup>232</sup> The Mauritius tariff liberalisation programme aims to achieve a low uniform level of protection for the manufacturing sector.<sup>233</sup> On the contrary for South Africa (SACU) tariffs

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<sup>226</sup> P Elango & P Kalenga 'Whither the SADC Customs Union?' in A Bosl et al (n 18 above) 123. P Kalenga 'SADC and the challenge of customs union status in 2010' paper presented at the Fifth Southern African Forum on Trade (SAFT) held in Pretoria, South Africa on 06-07 August 2008. Liberalising Trade in Southern Africa: Implementation challenges for the 2008 SADC FTA and beyond.

<sup>227</sup> P Elango and P Kalenga 'Whither the SADC Customs Union?' in A Bosl et al (n 18 above) 123.

<sup>228</sup> L Kritzinger-van Niekerk & EP Moreira 'Regional Integration in Southern Africa: Overview of Recent Developments' World Bank Discussion Paper (2002) 9-26.

<sup>229</sup> P Elango and P Kalenga 'whither the SADC Customs Union?' in A Bosl et al (n 18 above) 124. P Kalenga (n 226 above) 96.

<sup>230</sup> P Elango and P Kalenga 'whither the SADC Customs Union?' in A Bosl et al (n 18 above) 124. P Kalenga (n 226 above) 99.

<sup>231</sup> P Elango and P Kalenga 'whither the SADC Customs Union?' in A Bosl et al (n 18 above) 124.

<sup>232</sup> P Elango and P Kalenga 'whither the SADC Customs Union?' in A Bosl et al (n 18 above) 124.

<sup>233</sup> P Elango and P Kalenga 'whither the SADC Customs Union?' in A Bosl et al (n 18 above) 124

remain an important instrument for industrial policy.<sup>234</sup> There is neither a high nor a low tariff per se, tariffs are set taking into cognisance sector specific needs. The South African National Industrial Policy Framework (NIPF) states “our fundamental approach is that tariff policy should be decided primarily on a sector by sector basis, cited by the needs and imperatives of sector strategies.”<sup>235</sup> The rest of the SADC Member States use tariffs as a revenue generating mechanism.<sup>236</sup>

As SADC enters this critical stage in its integration agenda, the critical challenge remains that of reconciling what currently seem to be the irreconcilable trade policies. This section of the paper looks at SADC Member States divergent trade policies.

### 3.1 Rationale for a SADC Customs Union

The debate about Africa’s development has been an ongoing debate for a considerable amount of time. Technocrats, politicians and academics have spent and still continue spend a considerable amount of time debating issues surrounding the developmental needs of the African continent. A lot of initiatives have been put in place to try to address the development of the African continent. Early in the new millennium, the United Nations (UN) adopted the Millennium Development Goals (MDGs)<sup>237</sup> and for a considerable amount of time the MDGs were a buzz word in discussions surrounding African development. Of late regional integration and the enhancement of intra-regional trade have taken centre stage on debates surrounding African development. African leaders have on various occasions expressed full support for regional integration and the need to enhance intra-African trade.<sup>238</sup> The question though is whether enhancing intra-regional trade is a strong basis for forming a customs union? In a study commissioned by the SADC secretariat in 2007 conducted by DNA, it was revealed that enhancing intra-regional trade alone was a very weak basis for forming a customs union.<sup>239</sup> A customs union is more than a trading bloc, if properly constituted a customs union will require Member States to cede sovereignty on issues such as trade policy to a supra-national body.<sup>240</sup> Looking at the way SADC integration has evolved; Member States have shown preference of co-operation to ceding sovereignty

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<sup>234</sup> R Davies (n 21 above) 7. P Elango and P Kalenga ‘whither the SADC Customs Union?’ in A Bosl et al (n 18 above) 124

<sup>235</sup> South Africa’s National Industrial Policy Framework. This approach was also endorsed in the ANC Polokwane Conference resolutions; as the ANC is the ruling party in South Africa, one can perhaps realise that this approach is here to stay.

<sup>236</sup> P Elango and P Kalenga ‘whither the SADC Customs Union?’ in A Bosl et al (n 18 above) 124.

<sup>237</sup> United Nations Millennium Development Goals.

<sup>238</sup> Statement by the Right Honourable P B Mosili Prime Minister of the Kingdom of Lesotho Delivered During the Centenary Celebration of the Southern African Customs Union held in Windhoek Republic of Namibia 22 April 2010.

<sup>239</sup> DNA (n 27 above) 56.

<sup>240</sup> DNA (n 27 above) 56.

to a supranational body.<sup>241</sup> However even on co-operation SADC member states have not shown the required level of commitment to inspire confidence that, they would fully co-operate in the SADC customs union arrangement. In an audit conducted on the implementation of the SADC free trade protocol it was revealed that most countries were lagging behind in implementing the free trade protocol,<sup>242</sup> the question that then arises is if countries did not fully co-operate in the FTA how much more in the customs union that requires a deeper level of integration?

Studies conducted elsewhere in the world have revealed that it is most appropriate to deepen the trade agenda through regulation when levels of intra-trade amongst the countries is already high than entering into agreements with the hope that intra-trade volumes will rise.<sup>243</sup> Most countries in SADC and COMESA have been members of FTA's for a considerable amount of time and although there has been improvement in trade volumes intra-regional trade seem to be dominated by South Africa.<sup>244</sup> It has been argued that there are no compelling arguments for a SADC customs union beyond a mere conventional logic of

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<sup>241</sup> C Ng'ong'ola (n 4 above) 487.

<sup>242</sup> An audit (2007) conducted on the implementation of the Trade Protocol commissioned by the SADC Secretariat found that four Member States-Malawi, Mozambique, Zimbabwe and Tanzania- were not up to date in implementing their tariff phase-down schedules and that non-SACU Members heavily backloaded their tariff phase down offers. Similarly, trade facilitation instruments were not being implemented and NTBs remained a serious barrier to trade.

<sup>243</sup> N Aminian et al 'Integration of Markets vs. Integration by Agreements' Policy Research Working Paper 4546, The World Bank: Development Research Group Trade Team (2008) 2. East Asian countries have integrated among themselves primarily via the markets and not by formal *de jure* trade agreements. In contrast, Latin America has a long history of legal trade treaties that attempt to bind themselves together. Employing various indicators of trade and economic integration, it is clear that East Asian economies are much more integrated among themselves than the economies of Latin America. The concept of "integration of markets" focuses on the idea that economies can integrate among themselves through the use of marketplace; i.e. the private sector to be the vanguard of trade integration. This has also been described as regional integration via *de facto* agreements. More concretely, this means that economies in a region trade intensively among themselves without explicit formal preferential trade agreements. To facilitate intra-regional trade without the help of regional legal trade agreements, some of the economies may pursue policies of unilateral domestic deregulation and trade liberalisation; while others may improve their infrastructure (such as ports and highways), streamline their custom procedures or pursue policies that may facilitate inward foreign direct investment. In other words, even integration via markets can entail the use of some business-friendly policies by individual economies even though no legal regional trade treaties are signed by government. "Integration by Agreements" focuses on trade integration via the use of formal or *de jure* trade treaties. This channel of integration emphasizes the primacy of legal instruments to further economic integration among countries. These two instruments of integration are very much related and indeed ultimately they are complementary. Integration of neighbouring markets without formal regional trade agreements can create uncertainty among business since the institutional foundation may not be sufficiently clear and transparent. Integration by agreements can be vacuous if the underlying economic factors are not favourable for integration. The important question then becomes: which instrument of integration is more successful and more fundamental in driving trade integration? What should be the logical sequence for policy makers when examining these two channels of integration?

<sup>244</sup> P Elango and P Kalenga 'whither the SADC Customs Union?' in A Bosl et al (n 18 above) 121.

advancing regional integration along the lines of the linear model of regional integration.<sup>245</sup> SADC is yet to come up with convincing economic justifications of establishing a customs union.

Conventionally, economists have argued that economic gains from a customs union are two pronged: the static welfare effects (trade creation) and dynamic effects (growth of output, investment and development).<sup>246</sup> Trade creation takes place when a member in a customs union switches from goods produced domestically (at relatively high cost) to goods imported from a lower cost firm located in a partner country.<sup>247</sup> This is opposed to trade diversion which takes place when a member switches from consumption of lower cost goods imported from outside the customs union to higher cost goods produced within the customs union.<sup>248</sup>

Dynamic gains can also be incurred if the formation of a customs union will result in income growth through the expansion of the productive capacity and output.<sup>249</sup> This is only possible if the formation of a customs union will result in a large competitive market which can spark greater investment. Dynamic gains will also depend on the extent to which the resulting customs union is outward –looking through a low external regime.<sup>250</sup>

Although this paper is for legal studies and not expected to dwell on economic aspects of the SADC customs union, 21<sup>st</sup> century dynamics compels all disciplines in science to demonstrate great awareness of what other disciplines contribute to the whole subject matter. Legally regional integration can be achieved in SADC but if the intended economic gains do not materialise, all will be meaningless.

As the economic justification for moving towards a SADC customs union is hard to find, the following discussions below will show that, there are still many legal complexes confronting the formation of a SADC customs union.

### 3.2 GATT Article XXIV: (5) (a)

Article XXIV: 5(a) of GATT 1994 states that the duties and other regulations of commerce imposed ‘at the institution of’ a customs union in respect of trade with other WTO Members ‘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

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<sup>245</sup> P Elango and P Kalenga ‘whither the SADC Customs Union?’ in A Bosl et al (n 18 above) 120. P Kalenga (n 226 above) 95.

<sup>246</sup> P Kalenga (n 226 above) 99. P Elango and P Kalenga ‘whither the SADC Customs Union?’ in A Bosl et al (n 18 above) 121. IM Rathumbu (n 24 above) 15. C McCarthy ‘The Challenge of Reconciling Revenue Distribution and Industrial Development in the Southern African Customs Union’ (2006) 8.

<sup>247</sup> P Elango and P Kalenga ‘whither the SADC Customs Union?’ in A Bosl et al (n 18 above) 121.

<sup>248</sup> P Elango and P Kalenga ‘whither the SADC Customs Union?’ in A Bosl et al (n 18 above) 121.

<sup>249</sup> C McCarthy (n 246 above) 9.

<sup>250</sup> P Kalenga (n 226 above) 99.

formation of such union'.<sup>251</sup> This provision requires SADC Member States to do a comparison of the ORCs imposed by individual Member States and the ORCs that will be in place after the envisaged customs union is formed.<sup>252</sup> Currently each Member State imposes individual ORCs on trade with external trading partners. After the formation of the customs union, Member States largely replace these individual trade regimes with a common external trade regime.<sup>253</sup> In keeping with the purpose of the RTA exception, the requisite comparison aims to ensure that the new external trade regime of the union does not raise barriers to trade with other Members.<sup>254</sup>

Firstly, after the formation of the envisaged SADC customs union a comparison will be done on individual countries ORCs before the formation of the customs and the ORCs adopted by the customs union.<sup>255</sup> It is argued that the comparison is not to be done on individual ORCs but rather the focus of the comparison should be the overall combined effect of all ORCs imposed by the RTA parties rather than the specific effects of any individual ORC or the ORCs imposed by one party.<sup>256</sup> It is always complex task to compare specific ORCs before and after the formation of the customs union because they are likely to be replaced by different ORCs under the new common external trade regime.<sup>257</sup>

Secondly, the comparison requires an assessment of the 'duties and other regulations of commerce imposed at the institution of' the customs union.<sup>258</sup> This includes all harmonised ORCs, as well as any un-harmonised ORCs that the parties to the union continue to apply on an individual basis. Such ORCs are not to be on the whole higher or more restrictive' than before. The words 'on the whole', demonstrate that the comparison is based on the overall, cumulative impact of the ORCs and not on specific ORCs. As a result, certain specific ORCs imposed by one or more RTA parties may be more burdensome, while others may be less burdensome.<sup>259</sup> However, if the ORCs 'as a whole' are more burdensome than before, the customs union cannot benefit from the exception in Article XXIV: 5, this is something SADC has to bear in mind. As indicated above any RTA treaty has to be in compliance with GATT 1994 as they derive their legitimacy from GATT 1994.<sup>260</sup>

As regard 'duties and charges' the RTA Understanding provides a methodology for determining their cumulative impact before and after the formation of the customs union,

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<sup>251</sup> GATT Article XXIV: 5(a).

<sup>252</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 249.

<sup>253</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 249.

<sup>254</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 250.

<sup>255</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 250.

<sup>256</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 250.

<sup>257</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 250.

<sup>258</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 250.

<sup>259</sup> NJS Lockhart & AD Mitchell 'Regional Trade Agreements under GATT' in AD Mitchell (n 32 above) 238

<sup>260</sup> Discussed above at 2.2.



based on ‘an overall assessment of weighted average tariff rates and customs collected.’<sup>261</sup> Paragraph 2 of the RTA Understanding states: *“This assessment shall be based on import statistics for a previous representative period to be supplied by the customs union, on a tariff-line basis and in values and quantities, broken down by WTO country of origin. The secretariat shall compute the weighted average tariff rates and customs duties collected in accordance with the methodology use in the assessment of tariff offers in the Uruguay Round of Multilateral Trade Negotiations. For this purpose, the duties and charges to be taken into consideration shall be the applied rates of duty.”*<sup>262</sup>

As regards ORCs other than duties and charges, the RTA Understanding is less explicit.<sup>263</sup> Paragraph 2 recognises that for the ‘overall assessment’ of ORCs ‘for which quantification and aggregation are difficult, the examination of individual measures, regulations, products covered and trade flows may be required’.<sup>264</sup>

### 3.3 Challenges in Harmonising SADC Countries Trade Policies

Deepening economic integration to the level of a customs union requires a great amount of work in harmonising external trade policies amongst the constituent Member countries of the customs union. Looking at SADC Member states external trade policies one discovers that there are great disparities which have a potential of hindering SADC’s integration plans.

#### (a) The Common External Tariff

A distinctive feature of a customs union is the common external tariff which the countries to the customs union apply to goods entering the customs territory from third countries.<sup>265</sup> The need for a common external tariff is over-emphasised by many scholars on regional integration. They describe the common external tariff as a key feature of a customs union.<sup>266</sup> A question that is worth posing though is how common is the common external tariff?

In terms of GATT Article XXIV: 8(a) (ii) the constituent Members of a customs union apply ‘substantially the same duties’ and other restrictive regulations of commerce to trade with third countries.<sup>267</sup> In *Turkey- Textiles* the Appellate Body noted that it is not required that each constituent Member of a customs union applies the same duties and other regulations of commerce as other constituent members with respect to trade with third countries.<sup>268</sup>

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<sup>261</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 238

<sup>262</sup> RTA Understanding Paragraph 2.

<sup>263</sup> NJS Lockhart & AD Mitchell ‘Regional Trade Agreements under GATT’ in AD Mitchell (n 32 above) 250.

<sup>264</sup> RTA Understanding Paragraph 2.

<sup>265</sup> C McCarthy (n 246 above) 7.

<sup>266</sup> GATT Article XXIV: 8(a) (ii).

<sup>267</sup> GATT Article XXIV: 8(a) (ii).

<sup>268</sup> *Turkey-Textiles Appellate Body Report* para 50.

Article XXIV: 8(a) (ii) requires that substantially the same duties and other regulations of commerce shall be applied, also the phrase ‘substantially the same’ offers to a certain degree ‘flexibility to the constituent members of a customs union in the creation of a common commercial policy.’<sup>269</sup> However the Appellate Body further noted that this ‘flexibility’ is limited, something closely approximating ‘sameness’ is definitely required.<sup>270</sup>

One phrase that one finds questionable as to why the drafters of GATT chose to put in the text is the phrase ‘substantially the same’. In all instances where the phrase ‘substantially the same’ is used in GATT provisions the WTO Panels and the Appellate Division have on all occasions avoided giving a binding interpretation living room for lots of debates which are never resolved.

Because the Appellate Body interpreted ‘substantially the same’ as approximating sameness the prevailing view as well as common practice in many customs territories is that the customs union needs to adopt a common external tariff.<sup>271</sup> Unlike in the case of liberalisation in the FTA where ‘substantially all trade’ has been debated over and over again and with various FTAs adopting different interpretations and exploiting flexibilities. In the case of a customs union there has been no such room created. As it will be discussed, with the level of disparities that exist in SADC, one perhaps reaches a conclusion that SADC negotiators might have to try and exploit the little ‘flexibility’ that the Appellate Body noted exists.

Noting the ‘limited flexibility’ regarding tariffs that customs union must apply to third countries, it becomes clear that the harmonisation process is indeed a challenging one for SADC. Currently 15 countries constitute SADC, with the 15 countries 5 countries are already members of an existing customs union (SACU). SACU Members already apply the same tariffs with countries outside the customs territory. SACU countries have approached SADC as one bloc; this has been evident in the SADC FTA process. Therefore for purposes of a SADC customs union, SACU countries ought to be regarded as one bloc. The process of harmonisation in SADC would therefore be the one involving 11 customs territories.

One of the critical challenges in coming up with a SADC common external tariff is the variance in the rationale for tariff policies amongst SADC countries.<sup>272</sup> Some SADC countries (such as SACU members) use tariffs as an instrument of industrial policy to protect their sensitive sectors, whilst others (such as Mauritius) use lower tariffs as a vehicle for integration into the global economy.<sup>273</sup> The other countries use tariffs as a revenue

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<sup>269</sup> *Turkey-Textiles Appellate Body Report* para 50.

<sup>270</sup> *Turkey-Textiles Appellate Body Report* para 50.

<sup>271</sup> P Elango and P Kalenga ‘whither the SADC Customs Union?’ in A Bosl et al (n 18 above) 1.

<sup>272</sup> P Elango and P Kalenga ‘whither the SADC Customs Union?’ in A Bosl et al (n 18 above) 1.

<sup>273</sup> P Elango and P Kalenga ‘whither the SADC Customs Union?’ in A Bosl et al (n 18 above) 1.

generating instrument for public budgetary purposes.<sup>274</sup> In formulating the SADC common external tariff the question then becomes which policies would be adopted to influence the common external tariff? Clearly they cannot all be adopted and they seem virtually impossible to harmonise.

Another challenge is the tariff regimes of various SADC countries. The tariffs on average range between 3.5% to about 14%.<sup>275</sup> Mauritius is at 3.5% with the lowest tariffs, Angola is at 7.1% and SACU at 8.2% also relatively low.<sup>276</sup> The tariff regimes also vary considerable in terms of distribution of tariff rates with Madagascar having 0-20% whilst some range from 0-500% or even more.<sup>277</sup> The number of tariff bands is between 2 and 100, where countries like Zambia, Malawi and DRC have the lowest number of tariff bands and SACU has the highest.<sup>278</sup> There is also a large variance in the number of tariff peaks as well as in the number of duty free MFN rates.<sup>279</sup> A country like Mauritius has over 80% of tariff lines duty free, also a number of other countries have bound a number of their tariff lines duty free.<sup>280</sup> The levels and coverage of these tariff bindings would to a large extent determine the maximum levels at which CET tariff would be set. Products cannot be increased beyond their level bound at WTO without concurrence of other WTO Members.<sup>281</sup> The difference in the coverage and levels of bound rates also reflects the flexibility enjoyed by Member States through special and differential treatment. In the case of a customs union such flexibility maybe eroded by the need to adopt a uniform CET across Member States. A case in point is SACU where uniform tariffs are applied by all Members despite the stark difference in the levels of development-ranging from Lesotho (as the least developed country-LDC) to South Africa (as the largest economy in the group with a diverse manufacturing base).<sup>282</sup>

Clearly wide differences exist amongst SADC Members on their objectives and the rationale informing their respective schedules and tariff policies. There is therefore a need for SADC countries to have clear and common agreements on the basic principles that would inform the basis of a CET. In doing that there are individual countries economic interests and WTO commitments to be taken into consideration.

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<sup>274</sup> P Elango and P Kalenga 'whither the SADC Customs Union?' in A Bosl et al (n 18 above) 1.

<sup>275</sup> P Elango and P Kalenga 'whither the SADC Customs Union?' in A Bosl et al (n 18 above) 1.

<sup>276</sup> P Elango and P Kalenga 'whither the SADC Customs Union?' in A Bosl et al (n 18 above) 1.

<sup>277</sup> P Elango and P Kalenga 'whither the SADC Customs Union?' in A Bosl et al (n 18 above) 126.

<sup>278</sup> P Draper et al (n 24 above) 12.

<sup>279</sup> P Draper et al (n 24 above) 13. Edwards & Lawrence (n 27 above) 4.

<sup>280</sup> P Elango and P Kalenga 'whither the SADC Customs Union?' in A Bosl et al (n 18 above) 125.

<sup>281</sup> GATT Article XXIV.

<sup>282</sup> F Flatters & M Stern 'Trade and Trade Policy in South Africa: Recent Trends and Future Prospects' (2007) 20. C McCarthy (n 246 above) 13. R Kirk & M Stern 'The New Southern African Customs Union Agreement' The World Economy Journal Vol.28 No2 (2005) 182.

## (b) The Revenue Challenge

Dependence on tariffs as a source of revenue for public budgetary purposes by a number of SADC countries constitutes a major challenge in the formation of a customs union. Even in this regard there is a variance to the level and extent on dependency on customs revenue in SADC. It is clear however that a number of countries in SADC largely depend on tariffs revenue for public budgetary purposes. In all countries in the region except South Africa, tariffs revenue is over 10% of total fiscal revenue. In countries such as Lesotho and Swaziland, the level of dependence is extremely high as 50%.<sup>283</sup>

The process of forming a customs union will involve a significant level of trade liberalisation.<sup>284</sup> The challenge in maintaining fiscal sustainability especially for LDCs and developing countries cannot be underestimated.<sup>285</sup> Some studies have revealed that a number of low-income countries have not been able to replace lost trade tax revenue from other revenue sources.<sup>286</sup> Obviously the fiscal situation cannot forever hold as an excuse in moving to the customs union. As LDCs and developing countries liberalise, care should be taken to broaden the effective tax base and seek alternate sources of revenue and if they are limited, better expenditure control should be exercised, however the latter suggestion cannot hold in SADC states where governments are confronted with so many challenges and also major players in economic activity.<sup>287</sup>

Suggestions have also been made that if the tax exemptions can be reviewed in SADC a lot of revenue can be collected, particularly since exemptions account for a large portion of lost revenue in SADC countries.<sup>288</sup> It would be possible to reduce tariff rates and recoup the revenue loss through doing away with some tax exemptions.<sup>289</sup> The dilemma is however that these tax exemptions are meant to attract foreign direct investment (FDI), something most African countries are struggling to attract. However a question worth posing is why are SADC countries trying to attract FDI if no contribution will be made to the overall tax base? SADC countries need to provide innovative incentives for investors that do not include giving tax exemptions that hamper a source of government revenue.

It has been highlighted that there is a strong need to improve measures to impose tax administration that will broaden the tax base with the goal of increasing reliance on

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<sup>283</sup> R Kirk & M Stern (n 282 above) 180.

<sup>284</sup> P Kandelwal 'COMESA and SADC: Prospects and Challenges for Regional Trade Integration' IMF Working Paper WP/04/227 (2004) 20.

<sup>285</sup> P Kandelwal (n 284 above) 20.

<sup>286</sup> T Baunsgaard & M Keen 'Tax Revenue and (or?) Trade Liberalisation' IMF Working Paper WP/05/112 (2005)3.

<sup>287</sup> P Kandelwal (n 284 above) 20. T Baunsgaard & M Keen (n 286 above) 4.

<sup>288</sup> P Kandelwal (n 284 above) 20.

<sup>289</sup> C Grandcolas 'VAT Best Practices' in R Krever (eds) VAT in Africa (2008) 124.

domestic sources of taxation.<sup>290</sup> For example a number of African countries do not have the capacity and technologies required to collect value added tax (VAT).<sup>291</sup>

### (c) The Challenge of Overlapping Membership

The high appetite for regional economic integration is nowhere in the whole world most prevalent than in the southern Africa. This is clearly shown by the number of RECs found in the region and the high level of participation into these RECs by southern African countries all of which constitute SADC. In principle and according to WTO law there is nothing that prevents a country from participating in many RECs. The problem only arises if the RECs are customs unions or plan to further deepen integration by forming customs unions. As indicated above, one distinguishing feature of a customs union is the common external tariff which all members of a customs union are required in trade with third parties. If a country is to become a member of two customs unions the question that arises is which common external tariff is the country going to apply in trade with third parties? Theoretical one may argue that a country can be a member of two customs unions if both customs unions have their tariffs aligned. This argument can stand in theory however looking at the different policy considerations that influence external trade policy; clearly it is impossible to have such in Southern Africa.

Clearly if a country is to become a member of two customs unions that would create major confusions to that country's external trade relations, if customs unions members do not all honour their obligations in the customs union that can effectively render the customs union arrangement null and void. Unlike an FTA a customs union requires a greater level of cooperation from members. In practice the interpretation given by the Appellate Body in *Turkey-Textiles* that allowed little room for 'limited flexibility' is rarely seen in practice, customs union members apply the exact external tariffs.

The case of SADC is one that is very complex. It is well known that the trade agenda is not the nucleus for SADC integration agenda. In fact one can well argue and say that the trade agenda is only a small part of the overall SADC integration agenda when one looks at all the areas of cooperation that SADC countries seek to cooperate on. If one looks at the broader agenda for cooperation in SADC, one begins to have better appreciation of perhaps why SADC countries are also members of various other RECs. Unlike COMESA and SACU, when SADC was initially formed the trade agenda was not there, the trade agenda only came in 1996 with the signing of the SADC Free Trade Agreement (FTA). SADC countries always pick and choose which areas they wish to cooperate on. A clear case in point is that of the current SADC Chair, the DRC chose not to be part of the SADC FTA citing reasons that they were not ready to open up as their economy remains fragile almost in all sectors.

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<sup>290</sup> P Khandelwal (n 284 above) 21.

<sup>291</sup> C Grandcolas (n 289 above) 123.

Going into the SADC customs union, there needs to be clear policy directions taken by individual countries on the future of their participation in RECs. If a country sees the need of being part of a particular customs union it has to choose one which suits its own domestic as well as external economic interests. Clearly a country cannot be a member of two customs unions.

Some scholars have suggested that the already existing customs unions such as SACU and the EAC can effectively be used to drive the customs union agenda of economic integration in the region.<sup>292</sup> The following part of the paper explores how viable an option it is to use SACU or perhaps disband SACU going into the SADC customs union.

#### **4 Which is a more feasible arrangement for a SADC customs union: Dismantling or Expanding SACU?**

SACU is the only customs union which is constituted by countries that are also all Members of SADC. Other countries with overlapping membership in SADC are not Members of RECs constituted by SADC Member states only. SACU is therefore in a way uniquely positioned in the integration agenda in Southern Africa. A question then arises as to what role SACU can play in further deepening regional integration in Southern Africa as SADC through the RISDP expressed ambitions to become a customs union by 2010. With SACU as an already existing customs union in Southern Africa one can look at SACU as a stumbling or a building block in SADC's integration agenda.

SACU can be looked at as a stumbling block to SADC's integration agenda as SACU contributes to the overlapping membership dynamic. Because Members of SACU are also Members of SADC, they cannot join the SADC customs union whilst they are still Members of SACU. For that reason SACU's existence is an impediment to SADC's integration agenda.

On the other hand SACU can be viewed as a building block that has held together 5 economies in Southern Africa for a period of 100 years. Going into a SADC customs union SACU is uniquely positioned as a customs union that can be expanded to include other SADC Member States.

This section of the paper will take a brief look at SACU's evolution over the years and the current arrangements that currently exist within SACU and assess whether SACU can be expanded to include other SADC Member states.

##### **4.1 Brief Overview of SACU 1910-2002**

If common political and economic goals were the main reasons why countries formed RECs as has been suggested by many scholars then SACU would have never come into existence.

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<sup>292</sup> P Draper et al (n 24 above) 35. P Kalenga (n 226 above) 99. P Elango and P Kalenga 'whither the SADC Customs Union?' in A Bosl et al (n 18 above) 121. IM Rathumbu (n 24 above) 144. C McCarthy (n 246 above) 21.

Formed in 1910<sup>293</sup> through an agreement between South Africa and 3 British territories the Member States neither shared any political interests nor economic destiny. Surprisingly the customs union is today the world's oldest customs union. Having recently celebrated 100 years<sup>294</sup> of existence Member states expressed committed to the existence of the customs union for different purposes.

SACU was formed during apartheid South Africa and the other parties to the agreement were under colonial rule. As soon the BLS countries gained independence from Britain, it became necessary that the SACU agreement be renegotiated as the BLS countries were now independent states.

### a) The 1969 SACU Agreement

Initially the 1969 was hailed as a satisfactory agreement by all parties to the agreement.<sup>295</sup> South African producers were guaranteed market access to the BLS and the BLS were guaranteed a source of revenue. The one thing that has managed to sustain SACU as an organisation is that Member states are always able to reach a decision and agree on something and the outcome of the agreement gives different benefits to different parties. For an example; the BLS and South Africa agreed in 1969 that the South African Board on Tariffs would make recommendations on external trade policy.<sup>296</sup> As the biggest and most industrialised economy within the common customs area South Africa was happy with the arrangement. The BLS countries were also happy with the arrangement as they did not have the technical capacity to administer such work.

The 1969 agreement was heavily criticised for its lack of democratic decision making institutions. The 1969 agreement provided for South Africa to determine the external tariff policy of the customs union: all changes to custom tariffs, rebates, anti-dumping and countervailing duties were effected by the South African Minister of Trade upon recommendations of the South African Board of Tariffs and Trade. Excise policy was determined by the South Africa's Minister of Finance. The 1969 Agreement did not provide for the creation of a secretariat to manage the affairs of the customs union. There was a customs union commission which held annual general meetings. There were no procedures in place to give guidance on compliance and dispute settlement mechanisms.

Because South Africa had the monopoly to determine SACU policies to promote and protect South African producers to the detriment of the BLS's developmental interests; it became apparent that a mechanism was needed to compensate the BLNs for the loss of policy space.<sup>297</sup> The way the SACU Revenue Sharing Formula (RSF) was designed took the above factors into cognisance. The RSF was applied to the BLS countries and South Africa received the net amount. In 1976 the 1969 SACU RSF was amended to include a 'stabilisation factor' which required that the BLS receive 17% and at most 23% of the value of their c.i.f imports

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<sup>293</sup> 1910 SACU Agreement.

<sup>294</sup> SACU Centenary celebrations took place in Windhoek Namibia on the 22<sup>nd</sup> April 2010.

<sup>295</sup> R Kirk & M Stern (n 282 above) 173. C McCarthy (n 246 above) 8.

<sup>296</sup> R Kirk & M Stern (n 282 above) 173. C McCarthy (n 246 above) 8.

<sup>297</sup> R Kirk & M Stern (n 282 above) 174.

from all sources plus excisable production inclusive of excise duties. In so doing SACU effectively adopted a “target rate” of 17%.<sup>298</sup>

The RSF with the ‘stabilisation factor’, provided an agreement for allocating tariff revenue to the BLS that was related to trade policy, consequently it could not be expected to reflect the welfare and distributional costs (the so-called price raising effect), which would change over time with tariff adjustments and the changing commodity composition of trade.<sup>299</sup>

The BLNS share of the common revenue pool increased substantially<sup>300</sup> in the latter part of the 1990’s raising questions about the long term sustainability of the formula. Another unusual feature about of the 1969 RSF was the inclusion of excise duties. Although excise duties can be used to discriminate against imports, they are fundamentally a domestic tax and are generally excluded from customs union payment regimes.

## 4.2 The 2002 SACU Agreement

After the attainment of democracy in South Africa in 1994 it became clear that South Africa was not satisfied with internal democracy alone, it had to extend democracy also to the regional blocs it belonged to. This necessitated the renegotiation of the 1969 SACU agreement which was characterised by its undemocratic nature. These negotiations for the 2002 SACU agreement started in 1995 and were eventually concluded in 2002. The new agreement encompasses three main areas, governance and administration, economic policy and regulatory issues, and revenue sharing.

### a) Governance of the Customs Union

The 2002 SACU Agreement provides for the establishment of an independent, fulltime but administrative secretariat to manage the affairs of SACU.<sup>301</sup> Namibia won the bid to host the SACU secretariat, the secretariat is therefore based in Windhoek Namibia. In terms of Article 7 of the 2002 SACU agreement SACU would establish amongst other institutions a Tariff Board which would replace the South African Board of Tariffs and Trade (BTT).<sup>302</sup> The SACU Tariff Board would be constituted by a panel of experts appointed (each Member State is entitled to nominate a candidate) to consider all changes to the common external tariff. All recommendations emanating from the Tariff Board are to be ratified by the SACU Council of Ministers, which will consist of one Minister from each Member State.<sup>303</sup> The Council will be supported and advised by a Customs Union Commission made up of senior SACU civil servants, and an independent but ad-hoc Tribunal to arbitrate on any

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<sup>298</sup> R Kirk & M Stern (n 282 above) 174.

<sup>299</sup> C McCarthy (n 246 above) 21 8. R Kirk & M Stern (n 282 above) 175.

<sup>300</sup> By late 1990’s the BLNS’s share was close to 50% of the total revenue pool.

<sup>301</sup> Article 7 of the 2002 SACU Agreement.

<sup>302</sup> The old South African Board of Tariffs and Trade have since been replaced by the International Trade Administration Commission (ITAC) which is constituted in terms of International Trade Administration Act 71 of 2002. The mandate of the SA BTT has since been transferred to ITAC which also covers the broader SACU pending establishment of Tariff Boards in the BLNS countries.

<sup>303</sup> Article 8 of the 2002 SACU Agreement.



disputes. Decisions of council and other SACU institutions will be made on the basis of Consensus.<sup>304</sup>

The technical work of the customs union is to remain with national bodies 'to be established by each Member state.'<sup>305</sup> Thus South Africa's ITAC is to remain with a national mandate rather than a SACU agreement. This remains unimplemented ITAC continues to play a role of a SACU Tariff Board. The SACU 2002 agreement came into effect in 2004 up to now the BLNS countries have not established national Tariff Boards. This is due to a lack of expertise from the BLNS as well as lack of established industries that these Tariff Boards would be imposing tariffs on behalf. This is largely due to various factors *firstly*; for all industries found in BLNS countries the parent company is usually in South Africa. *Secondly* South Africa accounts for more than 95% of SACU's industrial produce. For BLNS countries the cost that they would incur in operating national BTT's would be very excessive and would not be supported by the returns they would get out of operating such an institution.

### **b) Economic Policy Issues**

The 2002 SACU agreement provides for common policies in industry, agriculture, competition and unfair trade practices.<sup>306</sup> The Agreement does not provide any annexes to the issues listed above. The understanding was that existing policies in different countries would remain in place pending the development of new common policies and strategies. The development of common policies remains the responsibility of Member States rather than the SACU Secretariat. The divergent levels of development and capacity in terms of expertise have had severe implications in this regard. There has been no movement to try and harmonise on any levels as countries are still debating the directions that they should follow as individual countries. There are no indications that there might be movement in this regard even in the nearest future. For example in South Africa which is the biggest economy in the region different groups from the ruling party continue to express dissatisfaction about the country's economic policies. South Africa by virtue of the size of her economy would be

expected to provide leadership in this regard but with the direction-less debate that continues to take place in the country one wonders if South Africa will be able to provide leadership on this matter. Botswana the second largest economy in SACU seems to be speaking with one voice on economic policy issues, however Botswana cannot be looked at as an example for the broader SACU because they only have beef and diamonds to manage.

### **c) External Trade Relations**

Article 31 of the 2002 SACU Agreement deals with trade relations with third parties;

Article 31(2) provides that "*Member States shall establish a common negotiating mechanism in accordance with the terms of reference to be determined by the*

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<sup>304</sup> Article 17 of the 2002 SACU Agreement.

<sup>305</sup> Article 14 of the 2002 SACU Agreement.

<sup>306</sup> Part 8 of the SACU Agreement deals with the establishment of common policies. Article 38 deals with Industrial policy, Article 39 deals with Agricultural policy, Article 40 deals with competition policy and Article 41 deals with unfair trade practices.

*Council in accordance with paragraphs 2 and 7 of Article 8 for the purpose of undertaking negotiations with third parties.”*

Article 31 (3) provides that *“No Member State shall negotiate and enter into new preferential trade agreements with third parties or amend existing agreements without the consent of other Member States.”*

Before the 2002 SACU Agreement external relations of SACU were driven by the bilateral and regional alliances of individual Member states; rather than the customs union; As Kirk and Stern<sup>307</sup> note *“this is best illustrated by terms and operation of the Trade and Development Cooperation Agreement (TDCA) signed between South Africa and the EU in 2000.* The BLNS are not signatories to the TDCA; however, Article XIX of the 1969 Agreement requires that they concur with the terms of the TDCA.

The BLNS are also signatories to the Cotonou Agreement,<sup>308</sup> an agreement that South Africa is not a signatory to. Ever since the 2002 SACU agreement came into effect; SACU has up to date failed to develop a common negotiation mechanism. This is largely due to the fact that the Members have not shown the required level of commitment. SACU negotiators attempted to approach the Economic Partnership Agreements (EPA) negotiations as a single bloc but it was not long before it became apparent that they had only converged when the negotiations had started. The EU first made a proposal for the negotiating agenda and SACU had to respond under the Umbrella of the SADC EPA group. The parties did not develop the common negotiating position with a clear understanding of each party’s needs. This later transpired when individual Member States went on to sign Interim Economic Partnership Agreements (IEPA).<sup>309</sup> It is important to understand that the development of a common negotiating mechanism will only be credible once SACU has harmonised other policies identified above. Trade negotiations is a measure used to gain access to third markets, therefore by the time SACU engages third markets it is important that SACU Members imperatives are well understood and well acknowledged. This can only be achieved through harmonisation of internal policies; something that has proven to be very difficult for SACU Members.

#### **d) Revenue Sharing**

SACU’s revenue sharing formula is regulated by Article 34 of the 2002 SACU Agreement. Article 34 provides for the sharing of the revenue collected in each particular financial year to be distributed to the Member States. The Budget of the for the SACU Secretariat, the Tariff Board and the Tribunal for the related financial year will first be deducted

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<sup>307</sup> R Kirk & M Stern (n 282 above) 174.

<sup>308</sup> The Cotonou Agreement 2000.

<sup>309</sup> Botswana, Lesotho & Swaziland signed the IEPA whilst Namibia initialled and South Africa pulled out of the negotiations.

proportionally from the gross amounts of customs, excise and additional duties collected before distribution to Member States.<sup>310</sup>

The share of each Member State will be calculated from the following three components:

#### I. The Customs Component

The customs component consists of the gross amount of customs duties and specific and ad valorem duties leviable and collected on goods imported into the customs union and other duties collected on imported goods. Each Member State's share of the customs component shall be calculated from the value of goods imported from all other Member States in a specific year as a percentage of total intra-SACU imports in such year.<sup>311</sup>

#### II. The Excise Component

The excise component shall consist of the gross amount of excise duties leviable and collected on goods produced in the common customs area, but shall not include any duties rebated or refunded under the provisions of any law relating to excise duties. Each Member State's share of the excise component shall be calculated from the value of its Gross Domestic Product (GDP) in a specific year as a percentage of total SACU GDP in such year.<sup>312</sup>

#### III. The Development Component

The development component is funded from a fixed percentage of the excise component. Each Member state shall receive a share of the development component and the distribution of this component shall be weighted in favour of the less developed Member states.<sup>313</sup>

### 4.3 Expanding SACU

Article 6; of the 2002 SACU Agreement deals with the admission of new Members to SACU. The Article allows for countries which are not signatories to the 2002 SACU agreement to accede to the Agreement.<sup>314</sup> Any new Member to SACU can only be admitted through a unanimous decision of the council.<sup>315</sup> Article 6 (3) provides that *"The council shall determine the procedural and criteria for the admission of new Members."*<sup>316</sup> Rule 24 of Rules of Procedure for SACU Institutions provides that *"The issue of admission of new Members into SACU shall be dealt with once council has decided on the criteria for admission."*<sup>317</sup>

<sup>310</sup> Article 34(2) of the 2002 SACU Agreement.

<sup>311</sup> Article 34(3) of the 2002 SACU Agreement.

<sup>312</sup> Article 34(4) of the 2002 SACU Agreement.

<sup>313</sup> Article 34(5) of the 2002 SACU Agreement.

<sup>314</sup> See Article 6(1) of the 2002 SACU Agreement, emphasis added.

<sup>315</sup> See Article 6(2) of the 2002 SACU Agreement, emphasis added.

<sup>316</sup> See Article 6(3) of the 2002 SACU Agreement, emphasis added.

<sup>317</sup> See Rule 24 of Rules of Procedure for SACU Institutions, emphasis added.

In as much as the new SACU Agreement was signed in 2002 and came into effect in 2004 up until 2010 the SACU council has not determined an accession criterion into SACU. One can argue that one of the reasons the SACU council has not yet adopted an accession criteria is because of the outstanding harmonisation of key policies that the 2002 Agreement provides that they need to be harmonised. Any accession criteria that will be developed will be influenced by the common SACU policies in areas such as economic policy, external trade policy, competition policy etc. Any new Member that is to accede into the SACU agreement will therefore have to be prepared to accept all common SACU policies. This process however seems unlikely to take place in the near future when one looks at the recent developments within SACU as well as the old existing issues of vast levels of development and the different interests that each country has in the customs union. For the BLNS for example one can correctly assume that any talks about admission of new Members into SACU are welcomed for as long as that will not affect their share in the revenue pool. For South Africa on the other side talks about admission of a new Member into SACU are welcome for as long as that will not imply that South Africa will not be paying anything more to that Member than as things currently stand with the BLNS. Another factor that would largely influence South Africa's decision would be improved market access for South African products into that particular country.

It remains to be seen firstly how SACU will develop the common policies on areas identified in the 2002 Agreement and secondly how SACU will develop an accession criteria.

At the highest political level at the council level within SACU, the SACU Council of Ministers at their last meeting on the 17<sup>th</sup> of September 2009 held at Ezulwini in Swaziland one of the resolutions that were taken was that SACU needed to be positioned at the centre of the SADC Economic Integration Agenda. The resolutions went further to say that SACU needed to pursue a common vision and strategy in order to make it more attractive as an anchor/nucleus for deeper economic integration in Southern Africa.<sup>318</sup>

If all resolutions of SACU Council Ministers were followed upon properly and implemented SACU would be far ahead. Very little has been done to implement the 2002 Agreement. For SACU to be a credible body that can be attractive to non-Members SACU needs to start implementing its own resolutions. SACU Members also need to show the required level of commitment to SACU and respect the institutions of SACU.

The argument for using SACU as a nucleus for a SADC customs union is found in the principle of 'variable-geometry'.<sup>319</sup> The principle of 'variable-geometry' is one principle which gained popularity in European integration. Put in simple terms "variable-geometry" describes the idea of a method of differentiated integration which acknowledges that there are irreconcilable differences within the integration structure and therefore allows for a permanent separation between a group of Member States and a number of less integrated

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<sup>318</sup> 17 September 2009 SACU Press Statement 'Outcome of the Special SACU Council of Ministers meeting held on 17 September 2009 in Ezulwini Swaziland.

<sup>319</sup> C Jakobeit et al (n 24 above) 35. R Kirk & M Stern (n 282 above). C McCarthy (n 246 above) 21. P Draper et al (n 24 above) 30. P Kalenga (n 226 above) 99. P Elango and P Kalenga 'Whither the SADC Customs Union?' in A Bosl et al (n 18 above) 121. IM Rathumbu (n 24 above) 144

units. It expresses the notion that not every country need take part in every policy but some can cooperate more closely in areas that they are ready to co-operate closely on whilst others can join latter when they are ready to do so.<sup>320</sup> For example within the EU; not all Member States are members of the EURO and the Schengen passport union.<sup>321</sup>

In the case of SADC the argument that has been used is that; taking a look at issues like overlapping membership; vast levels of development and divergent tariff policies; SACU as an already established customs union presents an opportunity for SADC Members to simple accede into the SACU treaty. Obviously for that to take place SACU needs to be properly constituted and have all necessary policies in place and develop a clear accession criterion.

#### 4.4 Dismantling SACU

One of the problems facing the formation of the SADC customs union is the problem of overlapping membership by SADC Member States into various RECs. SACU is one such REC that SADC Member States overlap into and it is wholly constituted by SADC Member States. One would then suggest that because SACU Members are also Members of SADC and committed to the implementation of the SADC RISDP SACU Members ought to dismantle SACU and focus on the bigger SADC customs union that will be constituted by all SADC Member States that include SACU Members. In that way 6 countries within SADC would not have dual membership into RECs. At the moment only 2 countries Angola and Mozambique within SADC Member States that do not hold dual membership into RECs. Dismantling SACU would therefore mean that the problem of overlapping membership would be addressed step by step. That would also show commitment to an integration process in Southern Africa led by SADC as per the resolutions of the AU on regional integration.<sup>322</sup> It is well understood that regional economic integration although economic considerations are supposed to be the major influencing factor for any country when deciding to join a regional economic grouping in Africa political considerations have been a major influencing factor.<sup>323</sup> For example after South Africa's first democratic government was elected there were expectations that South Africa would join COMESA as COMESA was much more economically orientated than SADC. However South Africa joined SADC instead for various reasons, one of those reasons was the relationship between the ANC and many SADC governments during the liberation struggle. When one looks at SACU's political credibility in the broader African continent and actually compares that to that one of SADC. The spirit of brotherhood amongst Heads of States is stronger within SADC than in SACU. This is also supported by the fact that ever since the inception of SACU in 1910, SACU's highest decision making body is the Council of Ministers unlike in SADC where the highest decision making body is the Heads of States who meet regularly annually. On the contrary SACU Heads of

<sup>320</sup> 'Variable Geometry (Europe)' <http://europa.eu/scadplus/glossary/variable-geometry-europ-en.htm> (accessed 03/03 2010). C Grant 'Variable Geometry' Published in Prospect Magazine (July 2005) <http://www.cer.uk/articles/grant-prospect-july05.html> (accessed 03/03/2010). C Grant 'Can Variable Geometry Save EU Enlargement' October November 2005-CER Bulletin, Issue 44 <http://www.cer.org.uk/articles/44-grant.html> (accessed 03/03/2010)

<sup>321</sup> C Grant (n 321 above)

<sup>322</sup> P Draper et al (n 24 above) 8. Economic Commission for Africa 'Assessing Regional Integration in Africa II: Rationalising Regional Economic Communities' Addis Ababa: Economic Commission for Africa (2006).

<sup>323</sup> P Draper et al (n 24 above) 8.

States only met for the first time under the umbrella of SACU during the recent SACU centenary celebrations in Windhoek Namibia. There is no constant engagement at Heads of States level on SACU matters.

However the process of dismantling SACU; legally would not be an easy one. The 2002 SACU Agreement does not contain any provision regarding the dissolution of the customs union. The only Article found in the 2002 SACU Agreement is the Article dealing with the withdrawal of individual Member States from the customs union. Article 49 of the 2002 SACU agreement provides that *“If a Member State wishes to withdraw from this Agreement that Member State shall give notice thereof to all other Member States. If after consultation the Member States fail to agree on the date and conditions of the withdrawal, the agreement shall remain in force until twelve (12) months from the date of such notice and shall then cease to apply to the withdrawing Member State.”*<sup>324</sup>

SACU could possibly legally be dismantled if all Member State could invoke Article and give notice to withdraw from the SACU agreement in terms of Article 49. Once all Member States invoke Article 49 of the SACU Agreement SACU would immediately cease to exist.

The likelihood of that happening is very slim; one observer made an observation of the strong trade connections that exist within SACU Members and compared them to a South Africa dish called ‘pap’ “The close trade relations that exist within SACU is like ‘pap’ when you cook ‘pap’ and mix water with the mealie-meal; regardless of what technology you can bring there is absolutely no way you can be able to separate the two.”<sup>325</sup> This observation illustrates the way SACU economies are so closely linked for all reasons. For example more than 80% of Botswana’s foreign trade is with South Africa. The figure with other SACU Members is as high. If South Africa was to withdraw from SACU the devastating effect that would have on South African exporters is inconceivable. If any of the BLNS countries would withdraw from SACU the devastating effect that would have on their fiscal budget is also inconceivable.

## 5 Conclusion

Concluding a paper dealing with issues as complex as the ones identified in this paper is never an easy task. The advantages of regional integration are well known; however for any region to fully reap the benefits it is important for Member States to be fully prepared to tackle numerous challenges along the way. European integration which is often looked as the most successful integration in the world took decades to get to where it is today and there were challenges along the way and problems continue to face the EU even today.

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<sup>324</sup> Article 49 of the 2002 SACU Agreement.

<sup>325</sup> P Marishane ‘Presentation on SACU’ Economic Diplomacy Workshop hosted by the Department of International Relations and Co-operation (DIRCO) (2010)

SADC adopted the linear model of integration of which the next step of integration as envisaged in the RISDP is a customs union status. This paper has identified numerous challenges that confront a successful establishment of a SADC customs union. Unless the problems identified in the paper are resolved then successful integration in SADC is unlikely to be realised.

So what is required for SADC's integration to the customs union status to be successful?

*Firstly*, the issue of overlapping Membership into various other RECs needs to be addressed by individual countries as an imperative of their foreign policies. Individual countries need to be clear of what it is that they wish to achieve in regional bodies by first clearly identifying domestic priorities and thereafter identify which regional body is best suited to assist the country realise its priorities. In some cases a country can realise; there is no need to join any REC as membership to a REC can put further obligations to a country and offer fewer benefits. Switzerland for an example participates to a much limited extent on regional issues in Europe but remains a prosperous country with good diplomatic relations with its European counterparts.

*Secondly*, the different levels of development pose serious challenges as it translates to amongst other things, different policies adopted at country level which become very difficult to harmonise if not impossible at regional level. 'Variable-geometry' has been suggested as an option of which SACU the existing customs union could be used as a nucleus for a SADC customs union. SACU would open up for accession to SADC Members who are ready to proceed to the customs union level whilst those who are not ready to cooperate will be assisted to meet the requirements for accession into SACU. This is not something that would be unique to SADC; some EU Members are neither part of the Euro nor the Schengen passport union but they continue to cooperate on other areas.

*Thirdly*, although SACU has been suggested as a nucleus for a SADC customs union, an idea that SACU embraces also, however; serious challenges exist before SACU can be expanded. For SACU to be a credible nucleus for a SADC customs union the following need to be done:

- Full implementation of the 2002 SACU Agreement which involves:
  - Building strong and credible institutions to administer the 2002 SACU Agreement
  - Developing and harmonising policies in areas that have been identified in the 2002 SACU Agreement
  - Develop a clear accession criteria which will be influenced by the harmonised policies

- SACU Members also need to come up with mechanisms for better collection of revenue for government budgeting purposes and stop relying on SACU revenues as that is not sustainable in an expanded SACU.

The purpose of REC is improved market access and the reduction of other barriers to trade. Proceeding to a customs union level may not be the solution for SADC as studies commissioned by the SADC Secretariat have in fact confirmed. The integration agenda must not be an exercise out of touch with the realities on the ground affecting traders. With some SADC countries' lagging behind in implementing the SADC FTA it is difficult to understand why SADC would be moving to a customs union.

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