

Michigan Journal of International Law

Volume 18 | Issue 3

1997

Securing the Peace Dividend in the Middle East: Amending GATT Article XXIV to Allow Sectoral Preferences in Free Trade Areas

David R. Karasik
University of Michigan Law School

Follow this and additional works at: <https://repository.law.umich.edu/mjil>



Part of the [International Trade Law Commons](#)

Recommended Citation

David R. Karasik, *Securing the Peace Dividend in the Middle East: Amending GATT Article XXIV to Allow Sectoral Preferences in Free Trade Areas*, 18 MICH. J. INT'L L. 527 (1997).

Available at: <https://repository.law.umich.edu/mjil/vol18/iss3/4>

This Note is brought to you for free and open access by the Michigan Journal of International Law at University of Michigan Law School Scholarship Repository. It has been accepted for inclusion in Michigan Journal of International Law by an authorized editor of University of Michigan Law School Scholarship Repository. For more information, please contact mjil.repository@umich.edu.

STUDENT NOTE

SECURING THE PEACE DIVIDEND IN THE MIDDLE EAST: AMENDING GATT ARTICLE XXIV TO ALLOW SECTORAL PREFERENCES IN FREE TRADE AREAS

*David R. Karasik**

INTRODUCTION	528
I. POLITICAL AND ECONOMIC DEVELOPMENTS IN THE MIDDLE EAST	531
II. BENEFITS OF ECONOMIC INTEGRATION	534
A. <i>Theory of Economic Integration</i>	534
B. <i>Integration In Practice</i>	536
C. <i>Costs and Benefits of Integration</i>	537
III. THE LAW OF GATT ARTICLE XXIV	538
A. <i>Purpose of the WTO</i>	539
B. <i>The Article XXIV Exception</i>	539
C. <i>Economic Customs and Legal Realities</i>	541
1. Article XXIV is Seldom Complied With	541
2. Article XXIV Does Not Adequately Serve International Economic Interests	543
IV. MIDDLE EAST ECONOMIC INTEGRATION	544
A. <i>The Role of the WTO in the Middle East</i>	545
B. <i>Scenarios of Middle East Economic Integration</i>	546
C. <i>Sectoral Integration</i>	549
1. Advantages of STAs	549
2. Securing Peace	552
3. Potential Sectors	554
V. AMENDING ARTICLE XXIV	555
A. <i>GATT-Based Solutions</i>	556
1. Waiver	556
2. The Enabling Clause	559
B. <i>Amending the GATT</i>	561
CONCLUSION	563

* J.D., The University of Michigan Law School (1997); A.B., University of California, Berkeley (1993). The author wishes to express his sincere appreciation to the entire MJIL editorial staff for their dedicated assistance, encouragement and comraderie.

“He who desires peace should prepare for war.”

— Vergetius, 4th century, C.E.

“He should, however, also plan for peace.”

— Seev Hirsch¹

INTRODUCTION

With comprehensive peace negotiations continuing in the Middle East,² many observers predict a new era of increasing economic cooperation between Israel and its Arab neighbors.³ In part, this forecast reflects the philosophy that direct economic interaction is a necessary criterion to sustain peace between the Arabs and Israelis.⁴ For example, Israel is not likely to initial any peace agreement with Syria if such agreement lacks provisions for trade and other economic transactions.⁵

1. Seev Hirsch, *Trade Regimes in the Middle East*, in *ECONOMIC COOPERATION IN THE MIDDLE EAST* 282 (Gideon Fishelson ed., 1989).

2. As of January 1, 1997, several significant peace agreements have been signed between Israel and the Arabs. See Treaty of Peace Between the Arab Republic of Egypt and the State of Israel, Mar. 26, 1979, 18 I.L.M. 362; Treaty of Peace between the State of Israel and the Hashemite Kingdom of Jordan, Oct. 26, 1994, 34 I.L.M. 43; Israel-Palestine Liberation Organization: Declaration of Principles On Interim Self-Government Arrangements, Sept. 13, 1993, 32 I.L.M. 1525; Statement by the Cooperation Council of the Arab States of the Gulf on the Cancellation by the GCC of the Secondary/Tertiary Arab Boycott of Israel, Oct. 1, 1994, *Israel Information Service Gopher* (visited May 12, 1997) <gopher://israel-info.gov.il:70/00/mad/pce/941001.pce> [hereinafter *Israel Information Service Gopher*].

Of course, several major political issues have yet to be resolved, including the Israel-Syria and Israel-Lebanon peace processes, the status of Jerusalem, Palestinian water rights, Jewish settlements in the West Bank and Gaza and other issues.

3. See *Hearings Before the Senate Foreign Relations Committee on Near Eastern and South Asian Affairs*, 104th Cong., 1st Sess. (May 11, 1995) (statement of Neal M. Sher, Executive Director of American Israel Public Affairs Comm.) available in LEXIS, News Library, Curnws File [hereinafter Sher Testimony]. See also SHIMON PERES, *THE NEW MIDDLE EAST* (1993); Xia Haitao & Huang Xingwei, *Mideast in 1995: Peace-Making Leads to Economic Cooperation*, XINHUA NEWS AGENCY, Dec. 14, 1995, available in LEXIS, News Library, Curnws File; Derek Brown, *Israel and Qatar Conclude \$1.2bn Natural Gas Deal*, THE GUARDIAN, Nov. 1, 1995, at 21; Peres: *There's No More Reason For War*, THE JERUSALEM POST, Feb. 4, 1996, at 2.

4. See Protocol on Economic Relations Between the Government of the State of Israel and the P.L.O. Representing the Palestinian People, May 1, 1994, pmbl., 33 I.L.M. 696. See also Avraham Azrieli, *Improving Arbitration Under the U.S.-Israel Free Trade Agreement: A Framework For A Middle-East Free Trade Zone*, 67 ST. JOHN'S L. REV. 187, 190-91 (1993); Daniel Lubetzky, *Incentives for Peace and Profits: Federal Legislation to Encourage U.S. Enterprises to Invest in Arab-Israeli Joint Ventures*, 15 MICH. J. INT'L L. 405, 409-10 (1994) (discusses the use of economics to advance peace).

5. See Mounir B. Abboud, *An Open Mid-East Market Will Grant Israel a Central Role*, SAUDI GAZETTE, Mar. 22, 1994, available in LEXIS, News Library, Curnws File. However, most Middle East analysts contend that a final settlement of the remaining political issues between the Arabs and Israelis must precede any discussion of future economic relations. For

Many analysts and politicians have been considering the concept of a Middle East regional trade association as a significant component of the economic relations that will be necessary to sustain peaceful relations in the region.⁶ These analysts and politicians recognize the importance of liberalized trade and integrated markets to establish and preserve peace in the region, as well as to maximize allocative efficiencies for the region's productive resources. In turn, these observers predict that the mutual benefits of trade and expanding interdependence will create "vested interests" to maintain peaceful and cooperative relations.⁷

Of course, it would be nearly impossible to predict the exact form of this increasing economic interaction. The possibilities could range from complete economic integration involving zero trade barriers to more limited forms of economic interaction. Nevertheless, whatever trade regime is ultimately established, it must comply with the World Trade Organization's (WTO) rules governing international trade, at least to the extent that those Middle East nations are signatories to that treaty.⁸ Thus,

example, Seev Hirsch claims that "it can be rightly argued that it is the nature of the political settlement which will provide the framework for economic relations and not the other way around." Hirsch, *supra* note 1, at 269.

6. See *id.* See also PERES, *supra* note 3; King Hussein Ibn Talal of Jordan, Address at the Opening Ceremony of UNESCO's International Symposium on the Future of the Mediterranean After the Peace Process (1995), in *Jordan's King Husayn Calls for Regional Bodies to Achieve Security and Free Trade*, BBC SUMMARY OF WORLD BROADCASTS, Feb. 21, 1995, available in LEXIS, News Library, Curnws File; Azzieli, *supra* note 4, at 191 (expressing hope for a "Middle East Economic Community").

7. See Lubetzky, *supra* note 4, at 409. The idea that economic interdependence is a significant factor in preventing war is a popular theory among liberal perspectives of international political economy. See ROBERT GILPIN, *THE POLITICAL ECONOMY OF INTERNATIONAL RELATIONS* 31 (1987); Mounir B. Abboud, *Arabs Still Looking for Common Ground*, SAUDI GAZETTE, Aug. 14, 1994, available in LEXIS, News Library, Curnws File. See generally RUTH ARAD ET AL., *THE ECONOMICS OF PEACEMAKING* (1983).

8. Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, April 15, 1994, LEGAL INSTRUMENTS—RESULTS OF THE URUGUAY ROUND vol. 1 (1994), 33 I.L.M. 1125 (1994) [hereinafter WTO]. The WTO annex 1A includes a document labelled "GATT 1994" which is essentially an updated version of the 1947 GATT. Hereinafter, [all GATT citations are to GATT 1994, as amended].

On January 1, 1995, the WTO succeeded the General Agreement of Tariffs and Trade (General Agreement, or GATT) as the principal legal institution of the multilateral trading system. The WTO's rules cover most aspects of world trade in goods and services, and the WTO is also the primary international forum for negotiating and settling disputes on all trade matters. The WTO attempts to liberalize international trade by enforcing international contractual obligations that define how nations may implement their domestic trade legislation. See *WTO World Wide Web Home Page*, (visited Feb. 14, 1997) <http://www.wto.org/wto/about_wpf.html> [hereinafter *WTO Web Page*].

As of May 16, 1997, 131 nations are members of the WTO and an additional 29 nations have applied for admission. *Id.* at <http://www.wto.org/wto.memtab2_wpf.html>. WTO member countries account for 90-95% of world trade. See *id.* at <<http://www.wto.org>>. As of March 15, 1997, Middle East WTO Members include Bahrain, Egypt, Israel, Kuwait, Morocco, Qatar, and United Arab Emirates. Countries being reviewed by WTO accession working parties include Algeria, Jordan, Oman, and Saudi Arabia. *Id.* at <http://www.wto.org/wto.memtab2_wpf.html>.

an important issue emerges: how should Middle East nations structure their future economic relationships to secure their peaceful reconciliation while simultaneously fulfilling their WTO obligations?

This note suggests two solutions to this quandary. First, the newly emerging bloc of peace-declaring nations in the Middle East should consider establishing a regional free trade area. However, instead of reducing the tariffs of "substantially all" of the region's products as would normally be required by Article XXIV of the General Agreement on Tariffs and Trade (GATT)⁹—the authoritative provision regulating free trade areas—this note argues that a Middle East free trade area should reduce trade barriers only for certain economic sectors, such as textiles and chemicals. Such a scheme will be termed a "sectoral trade area," or "STA." Second, and in furtherance of the STA scheme, this note argues that Article XXIV does not adequately facilitate peaceful political and economic relations between formerly belligerent and lesser-developed nations that have low levels of economic interaction. Accordingly, Article XXIV should be amended to allow STAs as described above under narrowly defined and closely monitored situations.

This note discusses these two propositions in depth. Part I briefly discusses the current political and economic developments in the Middle East that lead the parties toward greater economic interaction. Part II illustrates how the Middle East region would benefit by establishing a formal regional trade area. Part III analyzes the legal constraints imposed upon regional trade associations by GATT Article XXIV and explains how such rules impair not only the Middle East peace process in particular but also international economic interests in general. Part IV surveys the various models for economic integration in the Middle East currently discussed by academics and policymakers and demonstrates why sectoral trade liberalization offers the most benefits on balance. Finally, Part V provides the policy justification for amending GATT Article XXIV to allow sectoral preferences in regional trade areas.

Some Middle East countries are GATT signatories but not WTO members. These include Iran, Iraq, Lebanon, Libya, and Yemen. Edmund O'Sullivan, *The Middle East Plays the GATT Game*, MIDDLE EAST BUS. WKLY., Apr. 22, 1994, at 4. Former GATT members do not have an automatic right to join the WTO. A two-thirds majority of WTO members is needed to approve the terms of a country's accession to the WTO. WTO art. XXI para. 2.

9. General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, T.I.A.S. 1700, 55 U.N.T.S. 194 [hereinafter GATT] art. XXIV, para. 8.

I. POLITICAL AND ECONOMIC DEVELOPMENTS IN THE MIDDLE EAST

The momentum towards increased economic and political integration in the Middle East has been deemed "irreversible."¹⁰ The region's political leaders have stated that they are committed to the peace process,¹¹ and more specifically to the broad concept of a Middle East free trade zone.¹² Moreover, the recent peace agreements between Israel, Jordan, Egypt, and the newly formed Palestinian entity provide the political and legal foundation for widespread economic development in the Middle East.¹³

Several contemporary sociopolitical and economic events explain the Arab and Israeli interest in developing closer economic relations. Among these include the collapse of the Soviet Union,¹⁴ the 1992 Israeli Labor Party victory, the volatility of oil prices,¹⁵ the inadequate Arab infrastructure to manage high population growth¹⁶ and the poor record of Arab development programs in improving their agricultural, industrial, and financial sectors.¹⁷

10. See The Israeli-Palestinian Interim Agreement on the West Bank and the Gaza Strip, Sept. 28, 1995, prml., *Israel Ministry of Foreign Affairs Gopher* (visited May 12, 1997), <http://www.israel_mfa.gov.il/peace/interim.html>. See also *Special State Department Briefing by Dennis Ross, Special Middle East Coordinator*, FED'L NEWS SERV., Jan. 17, 1997, available in LEXIS, News Library, Curnws File; David Lamb, *Arabs See There's No Turning Back Now*, L.A. TIMES, Sept. 28, 1995, at A1; Glenn Frankel, *Netanyahu Reaffirms Dedication to Peace: New Israeli Leader Sets the Stage for Trip to Washington*, INT'L HERALD TRIB., July 5, 1996.

11. See John Lancaster, *Middle East Summit Opens; Economic Conference Aims to Turn Peace into Regional Prosperity*, WASH. POST, Oct. 31, 1994, at A15. See also Foreign Minister Shimon Peres, *Remarks to the Jerusalem International Business Conference* (Oct. 31, 1993), *Israel Information Service Gopher*, *supra* note 2 at <gopher://israel-info.gov.il:70/00/mad/pce/pce.1>.

12. See MEED Conference, *MEED Conference: The Economics of the Middle East Peace Conference*, MEED MIDDLE EAST BUS. WKLY., Jan. 21, 1994, at 5, available in LEXIS, News Library, Curnws File; Diana Abdallah, *Arabs Urged to Create Economic Bloc*, REUTER EUR. BUS. REP., Jan. 9, 1995, available in LEXIS, News Library, Curnws File; *Arab Free Trade Talks Open in Egypt*, U.P.I., Sept. 18, 1996, available in LEXIS, News Library, Curnws File; *GCC Agrees On New Moves Towards Common Market*, REUTERS WORLD SERV., Dec. 7, 1994, available in LEXIS, News Library, Curnws File.

13. See Sher Testimony, *supra* note 3.

14. *When History Passes By*, THE ECONOMIST, Arab Survey, May 12, 1990, at 3.

15. *Oil to the Rescue?*, THE ECONOMIST, Arab Survey, May 12, 1990, at 17.

16. *Pop*, THE ECONOMIST, Arab Survey, May 12, 1990, at 4; Edmund O'Sullivan, *New Era for Middle East Economies*, MEED MIDDLE EAST BUS. WKLY., Jan. 6, 1995, at 2 [hereinafter O'Sullivan, *New Era*].

17. See THE PROBLEMS OF ARAB ECONOMIC DEVELOPMENT AND INTEGRATION 177-99 (Adda Gueciouer ed., 1984).

Increased Israeli and Arab cooperation is manifest in numerous agreements that address diverse economic areas. Such agreements cover private sector development,¹⁸ water;¹⁹ energy;²⁰ establishing a Regional Bank for the Development of the Middle East;²¹ and Industrial Parks.²² These developments also coincide with economic liberalization programs in several Arab Middle Eastern countries.²³

The potential of the Middle East to be a lucrative market makes a stable economic environment a worthwhile goal,²⁴ and is attributable to

18. See *Middle East/North Africa Economic Summit, Oct. 30–Nov. 1, 1994, Casablanca Declaration, Israel Information Service Gopher*, *supra* note 2, at <gopher://israel-info.gov.il:70/00/mad/pce/941101.pce>; Gary G. Yerkey, *U.S., Israel, Palestinians Set Up Panel To Spur Economic, Political Cooperation*, BNA INT'L TRADE REP., Oct. 4, 1995, at 1663. See also David P. Fidler, *Foreign Private Investment in Palestine: An Analysis of the Law on the Encouragement of Investment in Palestine*, 19 FORDHAM INT'L L. J. 529 (1995) (analyzing the Law on the Encouragement of Investment adopted by the Palestinian National Authority in April, 1995).

19. See *Multilateral Working Group on Water Decides on Regional Projects*, June 23, 1995, *Israel Information Service Gopher*, *supra* note 2, at <gopher://israel-info.gov.il:70/00/mad/multi/950623.mul>.

20. See *Arabs and Israel: Iran and Pipelines*, THE FIN. TIMES LTD. ENERGY ECONOMIST, Jan. 1994, available in LEXIS, News Library, Curnws File.

21. See *Middle East Regional Development Bank*, Jan. 10, 1995, *Israel Information Service Gopher*, *supra* note 2 at <gopher://israel-info.gov.il:70/00/mad/pce/950110.pce>. Although, the chance for this to occur appears to be remote after several Gulf countries refused to finance the bank, stating that such a move was "premature until Israel troops leave occupied Arab lands in the West Bank, Gaza, Syria and Lebanon." Youssef M. Ibrahim, *Arab States Rule Out Regional Bank*, INT'L HERALD TRIB., Feb. 14, 1995, available in LEXIS, News Library, Curnws File. The United States insists that the idea will still be pursued. *Id.*

22. See *Peres-Major Meeting—Industrial Parks, Regional Bank*, Mar. 13, 1995, *Israel Information Service Gopher*, *supra* note 2 at <gopher://israel-info.gov.il:70/00/mad/pce/950313.pce>.

23. See *New Era Dawns for Markets on the Move*, MEED MIDDLE EAST BUS. WKLY., Apr. 14, 1995, at S2, available in LEXIS, News Library, Curnws File; Paul Lewis, *A Hard-Liner's Ballot Victory Doesn't Panic Israeli Markets*, N.Y. TIMES, July 5, 1996, at D1; Sami Aboudi, *Palestinians Take the Plunge: Stock Exchange Planned for Nablus in Effort to Attract Capital*, WASH. POST, July 21, 1996, at H2.

24. Economists have attempted to quantify the potential for growth and development under conditions of peace in the Middle East. For example, in 1989, Professor Haim Ben-Shahar estimated that:

[w]ithin ten years of peace, the GNP of Israel could be about 22 percent higher than in the absence of peace. Had the peace process begun in 1982 with accelerated economic growth accompanying it, by 1992 Israel's GNP could have been \$4.8 billion larger than is forecast with the continuation of existing conditions. Similar developments could have taken place in the Arab states bordering upon Israel: Egypt, Syria, Jordan and Lebanon. Had peaceful relations been established in 1982, the total GNP of these four countries could have been 24 percent, or \$20 billion, higher after ten years. The standard of living and per capita consumption, and of course, levels of investment would also have risen by similar percentages.

Haim Ben-Shahar, *Introduction, Economic Cooperation In the Middle East: From Dream to Reality*, in ECONOMIC COOPERATION IN THE MIDDLE EAST, *supra* note 1, at 5.

several elements. First, a "peace dividend" might be derived from a substantial decrease in defense expenditures and the ensuing release of those resources for productive employment.²⁵ Second, foreign direct investment will likely increase, thereby reducing the cost of capital. Third, the ensuing development of intraregional trade would increase specialization and trade based upon comparative advantage, creating additional sources of employment and investment opportunities, and stimulating economic growth as the region uses its resources more efficiently. Finally, cooperation in joint economic projects, particularly in the improvement of the region's water and transportation infrastructure would provide the necessary foundations for sustainable growth. All of these factors would improve the productivity, living standards, and growth of the region as a whole.²⁶

Of course, many Middle East countries will have to confront substantial structural problems before they can enjoy the benefits of peace and economic growth. For example, economic development in the region, especially in Arab, non oil-producing States, has stagnated for the past several decades²⁷ primarily because entrenched political monopolies, common in many Arab States, have hindered economic development.²⁸ In addition, the Arab economies have been industrially and agriculturally weak.²⁹

The Middle East region is a potentially enormous market for private sector investment. See Amy Dockser Marcus, *In the Middle East, The Newest Rivalry Is Over Cash, Not Arms*, WALL ST. J., Dec. 18, 1995, at A1. See also Neal Sandler & Kirk Albrecht, *Building Palestine Share By Share*, BUS. WK., Nov. 13, 1995, at 118E 6 (housing, hotels, and telephone networks); *Arabs and Israel: Iran and Pipelines*, *supra* note 20 (energy); Amy Dockser Marcus, *U.S. Banks Find New Opportunities in the Mideast*, WALL ST. J., Oct. 12, 1995, at A18 (banking); Ilene R. Prusher, *Likud's Pro-Business Plan is Economic Shift for Israel*, CHRISTIAN SCI. MON., June 26, 1996, at 8 (finance and investment).

25. In Israel for example, defense consumption as a percent of GDP has ranged from a low of 10.4% in 1966, to a high of 31.7% in 1975, and then progressively back down to 13.5% in 1989. YAKIR PLESSNER, *THE POLITICAL ECONOMY OF ISRAEL* 179 (1994). However, security costs will surely maintain high levels regardless of peace as Israel and Syria, for example, will undoubtedly continue to take considerable measures to ensure internal security.

26. The above analysis is suggested by Ben-Shahar, *supra* note 24, at 5-6.

27. SAMIR AMIN, *THE ARAB ECONOMY TODAY* 41-47 (1982) [hereinafter S. AMIN]. See generally GALAL A. AMIN, *THE MODERNIZATION OF POVERTY* (1974) [hereinafter G. AMIN].

28. Trade policy in many Arab countries historically has been characterized by relatively high levels of protection. Almost all the Arab countries began their independence after World War II with extensive barriers to imports. Pressures to liberalize remained politically weak through the 1970s as intellectuals in many Arab countries propagated the view that there was little prospect for export-oriented development. Moreover, Arab leaders often condemned liberalism largely for its association with colonialism. Finally, the balance-of-payments crises that plagued attempts at accelerated economic development were often dealt with by a combination of import and exchange controls. See ALAN RICHARDS & JOHN WATERBURY, *A POLITICAL ECONOMY OF THE MIDDLE EAST* 25-28, 219-37 (1989).

29. S. AMIN, *supra* note 27, at 76-81.

II. BENEFITS OF ECONOMIC INTEGRATION

While the above developments suggest reasons why the Arabs and Israelis should increase their economic interaction, the question then becomes in what form will this cooperation take place? This part discusses how economic integration in general takes place, describes the various methods to integrate economically, and surveys the problems that countries have historically faced during their attempts to form regional trade associations.

A. *Theory of Economic Integration*

Economic integration involves eliminating internal trade barriers among a group of countries while maintaining barriers against imports from nongroup countries with the hope of improving that group's economic position relative to the rest of the world.³⁰ Oftentimes, these trade associations are regional in nature, and are called "regional trade agreements" (RTAs).³¹

Several factors explain why nations form such trade arrangements. First, smaller countries may seek increased security of regional market access, thereby improving their bargaining power in multilateral trade negotiations³² or to express frustration with the slow pace of these multilateral trade negotiations, as occurred during the Uruguay Round.³³ Second, some countries wish to "promote industries that are not viable without a protected regional market . . . the idea being that they would be internationally competitive if given sufficient time to develop."³⁴ Furthermore, some nations join RTAs to secure non-economic objectives, such as strengthening political ties, managing migration flows, or to provide an insurance policy in case international institutions such as the WTO fail to enforce their rules.³⁵ Finally, of particular importance to lesser-developed countries (LDCs) in general, and many Arab countries in particular, a regional strategy reflects the limited success, if not the

30. NANSHI F. MATSUURA, *INTERNATIONAL BUSINESS* 113 (1991).

31. As used in this Note, the terms "region" and "RTA" do not necessarily contemplate geographic-proximity. Rather, they are used to describe any formal economic relationship between two or more countries.

32. RALPH H. FOLSOM ET AL., *INTERNATIONAL BUSINESS TRANSACTIONS IN A NUTSHELL* 168 (3d ed. 1988).

33. See Clinton Shiells, *Regional Trade Blocs: Trade Creating or Diverting?*, FIN. & DEV., Mar. 1995, available in LEXIS, News Library, Curnws File.

34. *Id.* Although Shiells points out that RTAs following this justification "have been the least successful in expanding trade and promoting regional growth." *Id.*

35. *Id.*

outright failure, of prior import substitution strategies³⁶—a reality that compelled the United Nations Conference on Trade and Development to recommend a regional strategy for LDC development.³⁷

There are several sub-categories of RTAs, including sectoral trade areas (STAs), free trade areas (FTAs), customs unions (CUs), common markets, complete economic unions, and complete political integration. An STA is an arrangement whereby nations negotiate tariff concessions for specific economic sectors. An FTA eliminates tariffs and quantitative restrictions between member-countries, but each country maintains its own tariff rates on imports from non-member countries. A CU involves, in addition to an FTA, the unification of tariffs against non-member countries. A common market is a CU plus the removal of restrictions on the movement of factors of production among member-countries. An economic union combines national economies into a single transnational economy, thereby adding to the common market situation the unification of economic and social policies among the member countries. This situation usually calls for the establishment of a supra-national decision making body. Finally, the highest form of integration, the political union, occurs when group of countries combine all government functions into one sovereign decision-making entity.³⁸

While the benefits of RTAs to member countries theoretically mirror those of multilateral free trade,³⁹ some scholars point out that RTAs are inherently discriminatory to non-member countries because RTAs are purposefully designed to provide benefits only for members of the trading bloc⁴⁰ and that these regional groupings might lead to resource reallocations which are economically undesirable.⁴¹

36. See Bassam Elias Harik, *Economic Integration in Less Developed Countries: Prospects for Six Arab Countries* 91–92 (1978) (unpublished Ph.D. dissertation, Wayne State University).

37. GILPIN, *supra* note 7, at 295. See also *Progressive Development of the Principles and Norms of International Law Relating to the New International Economic Order: Analytic Papers and Analysis of the Texts of Relevant Instruments*, reprinted in 21 I.L.M. 1478 (1982).

38. ELIAS T. GHANTUS, *ARAB INDUSTRIAL INTEGRATION* 18–19 (1982).

39. For example, regionalism enables a manufacturer in a member country to reach a larger market thereby allowing that manufacturer to realize economies of scale which supports more efficient production structures by enabling the manufacturer to spread fixed costs over larger regional markets. Consumers will also enjoy the benefits of increased competition in the form of lower prices and more variety and quantity of goods and services. Increased competition also generally results in more innovation and improved product quality. See GILPIN, *supra* note 7, at 172–80; Ali M. El-Agraa, *General Introduction*, in *INTERNATIONAL ECONOMIC INTEGRATION* 1 (2d ed. 1988).

40. See KENNETH W. DAM, *THE GATT: LAW AND INTERNATIONAL ECONOMIC ORGANIZATION* 274 (1970).

41. While it is theorized that regional integration is beneficial because it might lead to a more optimal allocation of world resources, in practice, the actual economic effects of

B. Integration In Practice

In practice, the lower degrees of integration (STAs, FTAs and CUs) are widespread around the globe, and the higher forms (economic and political unions) are very rare.⁴² Most countries have resisted the higher forms of integration because they believe that this would intolerably

preferential trade agreements is unclear. See *The Right Direction?*, THE ECONOMIST, Sept. 16, 1995, at 23; *Battle Lines*, THE ECONOMIST, Dec. 24, 1994/Jan. 6, 1995, at 13.

The debate essentially focuses on the extent that regional associations encourage member countries to trade among themselves at the expense of outside countries. For example, in his seminal work, Jacob Viner showed that the creation of a CU or an FTA can have two serious effects: (a) a trade-creating effect and (b) a trade-diverting effect. JACOB VINER, THE CUSTOMS UNION ISSUE 41-55 (1950). As Professor Jackson summarizes, "[t]rade creation refers to the expansion of trade with efficient suppliers inside the CU or FTA. Trade diversion refers to a shift in trade from efficient suppliers outside the regional arrangement, to inefficient suppliers inside it, driven by the desire to take advantage of trade preferences." JOHN H. JACKSON ET AL., INTERNATIONAL ECONOMIC RELATIONS 465 (3d ed. 1995). Viner attempted to demonstrate how trade diversion represents a move away from the optimum resource allocation because certain countries inside the region may be higher real-cost sources than outside countries. Whether a FTA or CU benefits the global economy depends on whether trade creation or trade diversion predominates.

However, Viner's analysis is incomplete, as many other factors must be considered when assessing the merits of a CU or FTA. For example, eliminating tariff barriers between countries will change the relative prices which will shift the geographic origins of the products traded. Thus, whether a country will be better off depends on the price and income elasticities of demand for the products traded. In addition, the increase in the size of the markets may create economies of scale. Finally, with regard to FTAs, the existence of trade diversion will also depend on the rules of origin among the Member States; with regard to a CU, the rates of the common external tariffs will also be a substantial factor whether trade diversion will occur. In addition, according to Richard Steinberg, "... no economist has been able to determine *a priori* whether trade creation or trade diversion predominates in the formation of a regional bloc. . . . [Most studies] usually have been unsuccessful or expressed only as a broad and speculative 'suspicion.'" Richard H. Steinberg, *Antidotes to Regionalism: Responses to Trade Diversion Effects of the North American Free Trade Agreement*, 29 STAN. J. INT'L L. 315, 320-21 (1993).

The economic literature indicates much disagreement over the relevance of the trade diversion concern. See Paul R. Krugman, *Is Bilateralism Bad?*, INTERNATIONAL TRADE AND TRADE POLICY 9 (E. Helpman & A. Razia, eds., 1991) reprinted in JACKSON ET AL., *supra* at 465-67 (arguing that while the risk of trade diversion is a "weak point" in assessing the benefits of regional trading arrangements, regional arrangements may try to take advantage of their enhanced monopoly power in trade to raise their external tariffs to the optimal level); Mohammad Suleiman Nahar Bani-Hani, *Economic Integration in the Arab World: Application of Some Economic Concepts* 82-83 (1979) (unpublished Ph.D. dissertation, University of California (Riverside)) (pointing out the limitations of the trade diversion analysis, particularly that it does not account for income distribution between countries, the inevitability of trade diversion among LDCs, and its neglect of dynamic aspects of trade creation which is more important to the LDCs than the static concept.); JACKSON ET AL., *supra*, at 468-69 ("despite the theoretical uncertainty about the consequences of preferential arrangements, empirical economists typically argue that existing regional arrangements tend to have positive economic effects for their members and no more than minimal adverse effects on the rest of the world.").

42. Lower degrees include NAFTA, the United States-Israel FTA, and Mercosur—a CU among Brazil, Argentina, Paraguay, and Uruguay. The EU is the only example of a higher form of integration.

constrain their sovereignty in carrying out their trade and development policies. This prospect is a primary concern to many developing countries, since "their national consciousness is high and economic development to them is a postindependence endeavor."⁴³ In most cases, developing countries choose the FTA strategy, notwithstanding their sovereignty reservations, because the FTA option is more palatable to LDCs as a method to reduce trade barriers than to liberalize on a global scale.⁴⁴

Middle East countries have pursued varying economic and political development strategies ranging from the autonomous or self-reliant development approach advocated by dependency theorists (Syria, Algeria, and Libya) to more aggressive participation in the world economy (Israel, Egypt, and Morocco). There have been previous Arab attempts to achieve deeper levels of regional political and economic integration. For example, in the 1960s, Iraq, Syria, Jordan, and Egypt formed the Arab Common Market.⁴⁵ In 1981, the Gulf Cooperation Council⁴⁶ included Saudi Arabia, Kuwait, the United Arab Emirates, Bahrain, Qatar, and Oman. In 1989, Morocco, Algeria, Mauritania, Tunisia, and Libya united to form the Arab Maghreb Union, while Egypt, Iraq, Jordan, and North Yemen created the Arab Co-operation Council. Despite these ambitious plans for economic and political integration within these associations, "no practical benefit has emerged from this alphabet soup"⁴⁷ especially when compared to the European Union.

C. Costs and Benefits of Integration

The difficulties and risks of economic integration are important considerations when nations decide whether to adopt a regional economic

43. GHANTUS, *supra* note 38, at 19–20.

44. As an example, Wechter claims that "Mexico would be more likely to reduce trade barriers with the United States and Canada than with all the world's nations, as may be inferred by its prior hesitance to join GATT." Kevin Wechter, *NAFTA: A Complement to GATT or a Setback to Global Free Trade?*, 66 S. CAL. L. REV. 2611, 2622 (1993). Wechter further adds that "developing countries that had no prior interest or experience in free trade agreements will likely join an expanding trade bloc, lest they miss an opportunity that their sister countries are enjoying." *Id.* at 2625.

45. Recognized by GATT: Working Party Report, Apr. 6, 1966, B.I.S.D. (14th Supp.) at 20 (1966). The Arab Common Market eliminated customs duties and tariffs among its members but a common external tariff was never established. *See also* Shiells, *supra* note 33.

46. The Gulf Cooperation Council attempted to liberalize movements of capital and labor (in industrial and agricultural products but excluded petroleum), by establishing a common external tariff, and negotiating with the EU about a possible economic cooperation agreement.

47. *When History Passes By*, *supra* note 14, at 3. *See also* G. AMIN, *supra* note 27, at 28–34; THE PROBLEMS OF ARAB ECONOMIC DEVELOPMENT AND INTEGRATION, *supra* note 17, at 177–98; GHANTUS, *supra* note 38, at 57–82; Bani-Hani, *supra* note 41, at 117–61; Harik, *supra* note 36, at 132.

strategy.⁴⁸ Some nations are concerned that they will not be able to compete with countries who suddenly have greater access to their market, and that this will suppress their industrialization process. Another concern is that the countries forming the organization may not be similarly situated economically. Since many LDCs are often "more competitive than complementary [relative to each other] . . . their competitive interests make it hard for them to form a community."⁴⁹ Also, the possibility that one group of nations will disproportionately benefit can be politically divisive. As Gilpin argues, "[t]he very forces of economic nationalism that prompted the initial commitment to regional cooperation have led to its destruction as each nation has tried to advance its own national interests."⁵⁰ All of these concerns are strongly held by many Arab nations when contemplating opening their borders to Israel.⁵¹ Nevertheless, as Kindleberger insists, "[i]f the political difficulties can be overcome, . . . there can be little doubt that industrialization in large units is better than industrialization at the same levels of protection in five times that number."⁵² Thus, it is hoped that both the Arabs and Israelis stand to gain in absolute terms with greater economic interaction.

III. THE LAW OF GATT ARTICLE XXIV

Before speculating what a viable Middle East regional trade area would look like, it is important to understand the WTO's rules regarding regional associations. Specifically, GATT Article XXIV will be implicated should the Middle East region wish to establish a regional trade area or common market. This section discusses Article XXIV's rules and analyzes some of the problems that Article XXIV has caused in its governance of regional trade associations. Section A briefly outlines the legal principles of the world trading regime in goods as governed by the GATT. Section B analyzes Article XXIV's rules regarding regional trade associations (RTAs). Finally, Section C discusses how Article XXIV is applied to RTAs and argues that GATT's continued tolerance of legally infirm regional associations provides a basis to question the legitimacy of Article XXIV as an effective mechanism to regulate RTAs.

48. See Bani-Hani, *supra* note 41, at 99-112.

49. CHARLES P. KINDLEBERGER, *INTERNATIONAL ECONOMICS* 187 (5th ed. 1973).

50. GILPIN, *supra* note 7, at 295.

51. See *infra* Part IV.B.

52. KINDLEBERGER, *supra* note 49, at 187.

A. Purpose of the WTO

"The basic purpose of the General Agreement is to constrain governments from imposing or continuing a variety of measures which restrain or distort international trade."⁵³ To carry out this purpose, GATT adopts three fundamental tenets. First, trade should be conducted on a nondiscriminatory basis as embodied in the most-favored-nation (MFN) clause of Article I.⁵⁴ Second, Article II forbids WTO members from assessing duties to other WTO members in excess of the established "schedule of concessions."⁵⁵ Third, Article III obliges WTO members to observe the "national treatment" obligation of nondiscrimination against imports.⁵⁶ This means that all WTO members must afford the same treatment to all goods, whether produced domestically or imported.

B. The Article XXIV Exception

In order to facilitate the stated goal of increasing world trade by encouraging the integration of national economies,⁵⁷ GATT's drafters believed that so long as the trade association eliminated trade barriers within the trade area, "it was viewed as a step toward free trade, partial to be sure, but laudable nonetheless."⁵⁸ Accordingly, Article XXIV explicitly creates an exception to the Article I MFN obligation by allowing countries to establish trade associations that accord special trade privileges to member countries, such as lower tariffs, without making such privileges available to all other WTO members. Specifically, the Article XXIV MFN exception applies to three types of associations: (1)

53. JACKSON ET AL., *supra* note 41, at 290.

54. Article I reads: "any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties." GATT art. I, para. 1.

55. GATT art. II, para. 1(b).

56. GATT art. III, para. 2.

57. GATT art. XXIV, para. 4.

58. DAM, *supra* note 40, at 274. Incidentally, as Professors Carter and Trimble point out, the creators of the IMF, World Bank, and other international institutions "assumed that regional organizations might develop to supplement the efforts of the international entities. For example, the U.N. Charter specifically assumes the active existence of regional groups (Articles 52-54) . . ." BARRY E. CARTER & PHILLIP R. TRIMBLE, *INTERNATIONAL LAW* 497 (2d ed. 1995).

a "free trade area," (FTA)⁵⁹ (2) a "customs union," (CU)⁶⁰ and (3) an "interim agreement" necessary for the formation of an FTA or CU.⁶¹

At the same time, Article XXIV contains several provisions that attempt to mitigate the potential harm that these trade associations may inflict on non-members by attempting to ensure trade creation and to minimize trade diversion.⁶² First, paragraph 4 states that "the purpose of a customs union or of a free trade area should be to facilitate trade between the constituent territories and not to raise trade barriers to the trade of other contracting parties with such territories."⁶³ Second, paragraph 8 requires that trade barriers be eliminated on "substantially all the trade" of the group, to prevent trade diversion in particular goods.⁶⁴ Thus, the Article XXIV exception may not be used to provide merely an exchange of preferences on a bilateral basis. Third, paragraph 5 states that external trade barriers toward outside countries must not be higher on average after the establishment of the FTA or CU.⁶⁵ Fourth, paragraph 5(c) requires that the plan and schedule for the formation of such CU or FTA occur "within a reasonable length of time."⁶⁶ Finally, recognizing that these arrangements will be phased in over time, paragraph 7 requires that the countries establish a clear plan for the transition and prompt notification to the Contracting Parties.⁶⁷

59. GATT art. XXIV, para. 5(b) (defining an FTA as an association where each member country maintains its own tariff schedule applying to non-members while eliminating tariffs against imports from members).

60. GATT art. XXIV, para. 5(a) (defined as an FTA but with a common external tariff).

61. GATT art. XXIV, para. 5(c).

62. PATRICK LOW, *TRADING FREE* 97-127 (1993). See also *Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994*, prmb., reprinted in *The Results of the Uruguay Round of the Multilateral Trade Negotiations: The Legal Texts* 31 (GATT Secretariat 1994) [hereinafter *Understanding*].

63. GATT art. XXIV, para. 4.

64. GATT art. XXIV, para. 8. A GATT working party noted that while "substantially all" has never been defined, it clearly implies "less than all" trade. Working Party Report on the Agreement Between the EFTA Countries and Spain, Nov. 10, 1980, B.I.S.D. (27th Supp.) at 127, 130 (1981). Clearly though, trade agreements covering only one sector of the associations' economies, such as automobiles, would not be permitted.

65. Paragraph 5 states that "the duties and other regulations of commerce . . . in respect of trade with contracting parties not parties to such union or agreement shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce [previously applicable]." GATT art. XXIV, para. 5(a), (b). In an FTA, the obligation not to increase protection against non-members is absolute.

66. A "reasonable length of time" is now defined as ten years, except in "exceptional cases." *Id.* at para. 5(c).

67. GATT art. XXIV, para. 7. However, Article XXIV does not require that the Contracting Parties actually approve the RTA. In fact, out of 109 RTAs notified to the GATT between 1948 and 1995 (one-third of those occurred between 1990-1994), only sixty-four working parties were formed to evaluate their legality. Of those sixty-four, only six working party conclusions (all sanctioning them) were issued. *The Right Direction?*, *supra* note 41, at 23.

C. Economic Customs and Legal Realities

The increased use of RTAs represents a significant development of the international trade scene. The preference of most countries to form a regional trade association under the guise of Article XXIV,⁶⁸ coupled with GATT's members' unwillingness to prevent their formation, provides a basis to question the continued utility of Article XXIV's rules to regulate RTAs. First, because so few RTAs have historically complied with Article XXIV, the commitment to the multilateral liberalization rules that the WTO so forcefully espouses has been undoubtedly weakened. Second, the fact that Article XXIV's provisions have not been adequately enforced suggests that the law itself might not realistically serve international economic interests. The following parts will examine these two assertions in greater detail.

1. Article XXIV is Seldom Complied With

The application of Article XXIV has been a continuous source of contention among WTO members, as Article XXIV's rules have been interpreted inconsistently and have been applied ineffectively. For example, the standards of "substantially all" and "on the whole" detailed in paragraphs 5 and 8 respectively have "proved as impossibly vague as it sounds."⁶⁹ Indeed, no GATT working party has ever defined the "substantially all the trade" clause or, for that matter, has ever held that an RTA failed to meet that standard. Further, because GATT working parties have consistently abstained from either explicitly approving or rejecting an RTA's compliance with the "substantially all" standard in even the most "flagrant" cases, it appears as if a precedent has been established to grant much latitude under this provision.⁷⁰ Thus, it is not surprising that few RTAs have complied with Article XXIV.⁷¹ As

68. Between 1947 and 1994, 108 regional agreements notified GATT, and between 1990 and 1994, 33 new RTAs notified GATT. WORLD TRADE ORGANIZATION, REGIONALISM AND THE WORLD TRADING SYSTEM 1 (1995). "When the WTO was established on January 1, 1995, nearly all its members were parties to at least one [regional] agreement notified to GATT." *Id.* These range from CUs, like the EU, to FTAs such as NAFTA, to non-reciprocal preferential agreements like the Lomé Convention. Finally, the share of intra-regional world merchandise trade increased from 40.6% in 1958 to 50.4% in 1993, although this increase is mostly attributable to the development of the EU. *Id.* at 39.

69. DAM, *supra* note 40, at 275.

70. Wechter, *supra* note 44, at 2617.

71. See JACKSON ET AL., *supra* note 41, at 470. See also DAM, *supra* note 40, at 275. For example, with regard to the New Zealand/Australia FTA, the countries did not set out a plan and schedule of their FTA and the agreement "covered only about 50 percent of current trade between the two countries, and of that 50 percent about 90 percent was already on the free list.

Professor Jackson states, "the preference system has been tolerated, either by an explicit GATT waiver . . . or merely by inaction"⁷² and that "[l]egal arguments have often been ignored or resulted in a standoff without resolution."⁷³

Professor Dam offers two reasons for this practice of non-enforcement: (1) imprecise and ambiguous standards of application, and (2) underlying principles that make little economic sense.⁷⁴ Indeed, despite attempts to draft precise legal language in paragraphs 4 through 10 of Article XXIV, "[a]mbiguity rather than precision [has] reigned."⁷⁵ Dam points out that the regional agreements that preceded GATT did not comply with Article XXIV, and in the face of the conflict, "the GATT and not the regional groupings yielded."⁷⁶ Later trade associations reviewed by GATT working parties could likely be considered as outright preferential arrangements but were nevertheless defended as being close enough to Article XXIV's strictures which made it politically difficult for GATT working parties to treat them as violations of MFN.⁷⁷ Moreover, GATT working parties have historically tolerated RTAs notwithstanding their non-compliance because the GATT itself probably "would have been destroyed" had an attempt been made to prevent the formation of the European Economic Community in the 1950s and 60s on the ground that GATT had not been complied with.⁷⁸

There was an attempt during the Uruguay Round to strengthen Article XXIV by minimizing the potential trade diversion; unfortunately, this will most likely not ensure greater discipline or enforcement by WTO members. Specifically, the 1994 Understanding on Article XXIV introduced greater precision to (1) measure changes in levels of

The agreement thus involved commitments to eliminate existing restriction on only about 5 percent of total intermember trade." *Id.* at 283. See also Wechter, *supra* note 44, at 2616. A GATT Working Party report tolerated that agreement notwithstanding its legal infirmities by stating that it appreciated the difficulties for the two governments to agree immediately on a plan and schedule. Working Party Report on the New Zealand/Australia Free-Trade Agreement, Apr. 5, 1966, GATT B.I.S.D. (14th Supp.) at 115.

72. JACKSON ET AL., *supra* note 41, at 470.

73. *Id.*

74. DAM, *supra* note 40, at 275.

75. *Id.*

76. *Id.*

77. *Id.*

78. *Id.* at 291. Dam also concedes, however, that even though "the GATT has rarely been successful in forcing regional arrangements entirely into the Article XXIV mold is not to say that it has not had considerable influence at the margin. On the contrary, there is evidence, for example, that the GATT criteria were significant factors in the drafting of the Latin American Free-Trade Association treaty." *Id.*

protection after the formation of a RTA,⁷⁹ (2) establish timetables for completion of the integration process,⁸⁰ (3) oblige CU members to compensate non-members for any changes in bound levels of protection,⁸¹ and (4) provide working party review of CUs and FTAs.⁸² However, this note is skeptical that these changes will significantly improve the way Article XXIV is enforced. After all, enforcing Article XXIV would be self-defeating for many WTO members since a large number of WTO members themselves are members of “illegal” RTAs. As one commentator argues, for these countries to criticize a future proposed RTA under the authority of the Understanding would certainly “be hypocritical, and perhaps self-incriminating.”⁸³ Other economists share this cynicism: “asking [WTO members to adhere to the Understanding] is like asking criminals to decide on their own sentencing.”⁸⁴

Perhaps the only tangible benefit of the Understanding, however, is its attempt to resolve the issue whether the compatibility of an Article XXIV arrangement could be raised in dispute settlement proceedings.⁸⁵ Professor Jackson predicts that future dispute panel reports might refer to working party reports that comment on Article XXIV violations.⁸⁶

2. Article XXIV Does Not Adequately Serve International Economic Interests

As Dam and others assert, the “highly ambitious” rules of Article XXIV do not reflect economic or political reality. Dam claims that Article XXIV has suffered a loss of credibility “as a consequence of

79. The 1994 Understanding adopted a “weighted average” of the tariff rates and of customs duties applicable before and after the formation of the FTA or CU to evaluate whether the restrictions imposed on external parties are more restrictive. Understanding, *supra* note 62, at para. 2.

80. *Id.* at para. 3 (A “ ‘reasonable length of time’ referred to in paragraph 5(c) of Article XXIV should exceed 10 years only in exceptional cases.”).

81. *Id.* at paras. 4–6.

82. *Id.* at paras. 7–11.

83. Wechter, *supra* note 44, at 2620.

84. AEI Book Summary, *The Economics of Preferential Trade Agreements*, (Jadish Bhagwati & Arvind Panagariya, eds.) (Jan. 1997) <<http://www.aei.org:80/bs7246.htm>>.

85. Paragraph 12 of the Understanding states:

The provisions of Articles XXII and XXIII of GATT 1994 . . . may be invoked with respect to any matters arising from the application of those provisions of Article XXIV relating to customs unions, free-trade areas or interim agreements leading to the formation of a customs union or free-trade area.

Understanding, *supra* note 62, para. 12.

86. JACKSON ET AL., *supra* note 41, at 472.

repeated irresolution and compromise in GATT working parties."⁸⁷ In this regard, Dam argues that many RTAs polarize the international trading system if the RTA causes significant levels of trade diversion.⁸⁸ Other Article XXIV commentators contend that FTAs harm the international economic system on the grounds that FTAs represent an erosion of multilateral negotiation principles.⁸⁹

At the same time, a strong argument attacking Article XXIV's usefulness can be made from the opposite viewpoint, i.e. that Article XXIV is *too* restrictive, instead of not restrictive enough. Since limited preferential arrangements liberalize only a small fraction of the RTAs' economies, allowing these preferences might involve less discrimination against non-RTA members than CUs or FTAs, which, at least in theory, liberalize "substantially all" the inter-RTA trade. Thus, the justification for proscribing more limited sectoral arrangements is unclear. As Dam points out, "[c]ertainly it is strange to state, as Article XXIV in effect does, that discrimination is forbidden unless it is 100 percent effective."⁹⁰

The weaknesses of Article XXIV's inadequate procedural rules and the hesitation of WTO members to enforce Article XXIV's substantive prohibitions confirm Dam's forceful conclusion questioning "the wisdom of the flat prohibition of preferential arrangements,"⁹¹ including, as this note argues, its prohibition of sectoral liberalization. Accordingly, the above critique not only undermines the application of Article XXIV's rules, it also suggests that Article XXIV should be undermined.

IV. MIDDLE EAST ECONOMIC INTEGRATION

This section discusses the role of the WTO in influencing Middle East economic policy and analyzes several possible scenarios of economic relations between the Arabs and Israelis. It concludes that the region should establish a sectoral trade agreement (STA) that would provide tariff preferences for certain economic sectors. This strategy can

87. DAM, *supra* note 40, at 291. See also John H. Jackson, *Regional Trade Blocs and the GATT*, 16 THE WORLD ECON. 121, 126 (1993) [hereinafter Jackson, *Regional Trade Blocs*] (arguing that Article XXIV is an inadequate tool to regulate present-day regional economic associations).

88. Kenneth W. Dam, *Regional Economic Arrangements and the GATT: The Legacy of a Misconception*, 30 U. CHI. L. REV. 615, 624 (1963) [hereinafter Dam, *Regional Economic Arrangements and the GATT*]. Even so, as Steinberg points out, "neither a GATT dispute settlement panel nor the Contracting Parties have ever found trade diversion to be a suitable basis for attacking free-trade agreements." Steinberg, *supra* note 41, at 346.

89. See Gardner Patterson, *Implications for the GATT and the World Trading System*, in FREE TRADE AREAS AND U.S. TRADE POLICY (Jeffrey J. Schott ed. 1989), at 353-365.

90. DAM, *supra* note 40, at 289.

91. *Id.*, at 288.

encourage needed economic development to the region while accommodating manifest political and economic conditions that would prevent any greater degree of economic integration.

A. *The Role of the WTO in the Middle East*

While many Middle East countries are GATT and WTO members,⁹² thereby committing themselves to the principle of global free trade, there is little enthusiasm in the region for the general free trade agenda that the WTO encourages.⁹³ In practice, the majority of Middle East countries "are protectionist and are likely to stay that way for the years to come."⁹⁴ For example, Saudi Arabia has been reluctant, until recently, to accept the authority of international bodies over any aspect of its domestic policy.⁹⁵

However, several Arab States have joined the GATT/WTO system notwithstanding their reservations. First, GATT was accepted among many Arab States because it was simply deemed irrelevant. Even though GATT's rules are designed to reduce barriers and discrimination against merchandise exports, the Arab Gulf region's primary export, hydrocarbons, is exempted from GATT's Article I bindings.⁹⁶ If the WTO increases the global economy and growth rates as expected, Arab oil exports would likely increase to meet the increased global energy demand, thereby providing adequate foreign exchange to purchase increased imports.⁹⁷ Second, many Arab States decided to join the GATT/WTO system because they recognize that integration into the global economy is a necessary prerequisite for their economic development.⁹⁸ Third, as WTO members, Arab nations can exert some influence in international trade matters; outside, they would have none.⁹⁹ Many Arab countries also

92. See O'Sullivan, *supra* note 8.

93. *Id.*

94. *Id.* Many of the development policies pursued across the region over the past twenty years are far from the free trade model. Fixed exchange rates, customs duties on manufactured goods, restrictions on service suppliers, and preferential government purchasing programs characterize many Middle Eastern trade regimes. O'Sullivan further claims that "[e]ven if the idea of free trade has been accepted, the practical application of its principles might be highly unpopular among politically sensitive groups across the Middle East." *Id.*

95. *Id.*

96. O'Sullivan, *supra* note 8.

97. *Id.* Although it is warned that "such gains could not be achieved if consuming states go ahead with plans to impose new energy taxes." Nadim Kawash, *Arab Balance of Payments Hurt By WTO*, AGENCE FRANCE PRESSE, Mar. 27, 1996, available in LEXIS, News Library, Curnws File.

98. See *Energy: Mid-East Arab States To Attract More Investment*, INTER PRESS SERV., Mar. 17, 1997, available in LEXIS, News Library, Curnws File.

99. O'Sullivan, *supra* note 8.

realized and appreciated the WTO's attempt to liberalize trade barriers within their financial sectors.¹⁰⁰ Finally, the WTO could positively effect Middle Eastern countries' government procurement policies.¹⁰¹

Thus, in order for a successful regional agreement to be accepted across the diverse political and economic landscape of the Middle East, it is clear that it will have to provide some concessions to the Arabs to protect their resources and markets, yet liberalize trade to some degree to attract investment and development that the region so badly needs. In addition, whatever regional association is ultimately established, it must comply with international legal commitments as embodied in the WTO.

B. Scenarios of Middle East Economic Integration

To understand why an STA would be a viable regional trade policy in the Middle East, it is useful to discuss why other trade schemes would not. For example, one option might be for the Arab countries to first integrate their economies before joining Israel and other countries in a single market.¹⁰² During this period, the Arab States could "consolidate democracy in their political and economic systems and revise their policies on education, training, planning, and exploitation of resources."¹⁰³ Such plans would supposedly draw from previous Arab attempts to integrate their economies as discussed *supra*.¹⁰⁴

Another option for a regional trade policy might be to establish an FTA in accordance with GATT Article XXIV—that is, an FTA covering substantially all those countries' goods and services. This idea might be feasible if Israeli-Arab trade would be balanced and not disproportionately one-sided. For example, in a study conducted by the Sharjah Chamber of Commerce and Industry of the United Arab Emirates, the Chamber argues that despite the fact that Israel "has built a relatively large export-oriented industrial base, its exports are equivalent to less than 10% of total Arab imports."¹⁰⁵ The study also contends that strong Israeli exports will have little impact on the Arab countries' level of

100. WTO, Press Release, Financial Services Agreement Confirmed—Statement By Chairman, Press/19, July 28, 1995. For example, if the WTO removes restrictions on the right of financial institutions to establish operations in Member States, this measure could have a major impact in Middle East countries that protect their banking systems and capital markets.

101. See O'Sullivan, *supra* note 8.

102. *Arabs-Israel—UAE Chambers Says Arabs Have Nothing to Fear From Israel in Common Market*, ARAB PRESS SERV. DIPLOMAT RECORDER, Apr. 30, 1994, available in LEXIS, News Library, Curmws File [hereinafter *Arabs-Israel*].

103. *Id.*

104. See *supra* Part II.B.

105. *Arabs-Israel*, *supra* note 102.

imports.¹⁰⁶ Thus, an argument can be made that Israeli industries pose little threat of “dominating” the Arab economies in the near or long term future. After all, as many economists argue, at least in theory, trade liberalization produces a net increase in all nations’ welfare.¹⁰⁷

However, the above models of integration are unfeasible in the Middle East for several reasons. The first scenario, Arab integration, would be unlikely considering that few benefits arose from prior Arab attempts to integrate their economies as explained *supra*.¹⁰⁸ Little new evidence suggests that future attempts would fare any better.

Attacking the second scenario, a full-scale FTA, requires more detailed analysis. One commentator warns against such a plan by pointing out that the time may not be ripe for such levels of economic integration “due to uncertainties about the Arab-Israeli peace process, the challenge of Islamic dissident movements and the lack of public awareness of the need for change [in Arab societies].”¹⁰⁹ A broader problem, documented by Henri Barkey, is that the countries comprising the Middle East are “unquestionably dissimilar in many respects, including levels of development, workings of the market, integration with the world economy, and systems of governance and legitimation.”¹¹⁰ In addition, many Arab countries’ political and economic systems might be unfit to handle high levels of capital investment that would occur under conditions of free trade with Israel and the rest of the world.¹¹¹ For example, the countries neighboring Israel, namely Jordan, Syria, Lebanon, and Egypt—the most likely candidates to form a Middle East regional association if Arab-Israeli relations continue to improve—currently suffer from low public sector production capacities, high production costs, inadequate agricultural and industrial technologies, relatively small private sectors, and elaborate social security systems. Moreover, attempting to establish a high degree of economic integration in the Middle East

106. *See id.*

107. *See GILPIN, supra note 7, at 172–80.*

108. *See supra* Part II.B.

109. O’Sullivan, *New Era supra* note 16, at 3.

110. Henri J. Barkey, *Introduction: Economic Reform in the Middle East, in THE POLITICS OF ECONOMIC REFORM IN THE MIDDLE EAST 5* (Henri J. Barkey ed., 1992).

111. For example, the Wall Street Journal reported that Israeli central bank governor Yaacov Frenkel said that Israel’s market-oriented economy is “incompatible” with those of regional Arab nations and dismissed visions of Mideast economic integration patterned after European or North American trade blocs. *World Wire: Israel’s Economy Sticks Out*, WALL ST. J., Sept. 14, 1994, at A14.

could have undesirable consequences because economic and social disparities will increase adjustment costs to an "intolerable level."¹¹²

Several Arab officials also warn that Israel would dominate Arab economies due to Israel's relatively superior industries. For example, the Sharjah study maintains that "Israel has a governmental, institutional, legal and administrative structure that is far superior to that in all Arab countries."¹¹³ These concerns may be further compounded by the fact that the Israeli economy is essentially a market-oriented capitalist economy that is well-suited to interact with foreign markets while many Arab countries are not.¹¹⁴ In sum, one scholar warns that Israel will benefit disproportionately more than the Arabs.¹¹⁵

In addition, from a global perspective, there is some evidence suggesting that an Article XXIV FTA among Israel and the Arabs would lead to trade diversion, i.e. buying relatively expensive Middle East products rather than buying cheaper from outside of the Middle East.¹¹⁶ Finally, as pointed out *supra* in the context of RTAs among LDCs, another potential and important issue of Arab-Israeli trade is the problem of non-complementarity.¹¹⁷ For example, while Jordan's main products are phosphates, vegetables, fruits, potash and fertilizers,¹¹⁸ there is some evidence that Jordanian exportable goods will not generate sufficient demand in Israel.¹¹⁹ Furthermore, it is alleged that the Jordanians are not genuinely interested in trade with Israel and will raise trade barriers to protect sensitive industries from Israel's exports.¹²⁰

112. Hirsch, *supra* note 1, at 281.

113. *Arabs-Israel, supra* note 102.

114. *Finding Common Economic Ground*, AL AHAM WKLY., Sept. 16, 1993, available in LEXIS, News Library, Curnws File.

115. *Finding Common Economic Ground, supra* note 114.

116. Again, the emphasis on trade diversion has been attacked. Despite the potential existence of trade diversion in a Middle East trade association, Harik states that "a strong case for economic integration can be argued on other grounds. One important factor is the extremely small size of the individual markets, which constitutes a serious constraint on the industrial development and economic growth." Harik, *supra* note 36, at 133. See also Paul Wonnacott & Mark Lutz, *Is There A Case For Free Trade Areas?*, in FREE TRADE AREAS AND U.S. TRADE POLICY, *supra* note 89, at 62-64 ("There are several grounds on which an FTA may be desirable even if it is predominantly trade diverting.")

117. See *supra* Part II.C. In other words, Arab-Israeli trade may lack pairs of goods for which consumption is interdependent, such as gasoline and autos, or hot dogs and mustard. This problem has been documented with regard to intra-Arab trade as well. See Bani-Hani, *supra* note 41, at 60. On the other hand, there is evidence that some economic complementarities do exist. See *infra* Part III.C.

118. Interview with Professor Eliahu Kanovsky in *The Economic Dividends to be Realized from Jordanian Treaty*, (Jul. 20, 1994) *Israel Information Service Gopher, supra* note 2 at <gopher://israel-info.gov.il:70/00/econ/eps/940720k.dps>.

119. *Id.*

120. *Id.*

C. Sectoral Integration

While both the Arabs and Israel might benefit from some form of a common market in the long term, "Israel will be the first to take the initiative and set trade conditions will also be the first to benefit from the economic relations which will emerge in the coming era."¹²¹ This concern poses a serious policy issue for Middle East nations when planning the nature of their economic relations. Expounding on the liberal view of political economy previously discussed,¹²² it will be essential to design and implement measures that will benefit Arabs and Israelis to such an extent that both sides would have "vested interests" in maintaining peaceful relations.¹²³ For example, Professor Hirsch argues that Middle East trade should be limited to transactions that satisfy this "vested interest" criterion.¹²⁴ This standard is useful because it recognizes that disproportionate economic gains by either side could produce intense commercial rivalry that could undermine the peace arrangement altogether. In order to satisfy this standard, this note argues that the Middle East should slowly integrate their economies by granting tariff preferences to goods and services where the countries have complementary production structures.

1. Advantages of STAs

An STA would be attractive to many Middle East governments because it offers many advantages over policies involving greater levels of economic integration. First, an STA would enable them to liberalize certain aspects of their economies while retaining some control over their internal markets and sensitive industries. Second, it provides a framework for the participants to assess the costs and benefits of their participation. For example, this scheme would address the legitimate Arab concern that Israel would reap disproportionate gains at their expense. Third, a sectoral approach would allow large-scale and growth-oriented industrial

121. *Finding Economic Common Ground*, *supra* note 114.

122. *See supra* note 7 and accompanying text.

123. ARAD ET AL., *supra* note 7, at 47-70. *See also* Interview with Hani Mulki, president of Jordan's Royal Scientific Society, *quoted in* Robert L. Pollock, Editorial, *A Prosperous Jordan is Good for Israel*, WALL ST. J., Feb. 7, 1997 at A18 ("Once the dividends come, . . . the people will protect the peace."); Interview with Ismail Osman, chairman of the Arab Contractors company, *quoted in* Cathy Waugh, *UNIDO: Mideast Business Boosts Peace*, U.P.I., Oct. 11, 1996, *available in* LEXIS, News Library, Curnws File ("Once economic interests have developed, people will want to preserve this wealth. They will be very careful to protect their interests."). *See also* Lubetzky, *supra* note 4, at 409-10.

124. Hirsch, *supra* note 1, at 281.

projects to mature throughout the region. Over time, these selected economic sectors would become competitive enough to enter global trade markets. Another advantage is that by “[w]orking within a sector, the interaction of tariffs, nontariff barriers, and policy intentions for the future could all be looked at simultaneously.”¹²⁵ Finally, Arab governments may find it more politically palatable to convince their respective domestic constituencies of the merits of limited sectoral liberalization, as opposed to an across-the-board liberalization program that Article XXIV requires—a trade policy that would represent a drastic shift in the Arab government’s previous economic development policies.

On the other hand, however, some analysts note that the sectoral approach imposes heavy transaction costs due to administrative and operational impediments such as much time consuming interfirm and interindustry negotiation.¹²⁶ Moreover, abuses might also arise as powerful domestic interest groups will undoubtedly strive to influence the government’s selection of which industries will be given preferential status.

Regardless, the advantages created by granting sectoral preferences outweigh the potential practical problems that might be encountered during the process of establishing the sectoral trading regime. This process is itself beneficial if it includes the private sector in the integration process and allows representatives of those selected sectors to exchange information about their production conditions. For example, by enabling those representatives to voice their proposals to their governments and encouraging those industrial sectors to cooperate with each other, non-tariff barriers used in a particular industry can also be addressed. Moreover, because the sectoral approach makes it easier to study the economic developments of a particular sector as opposed to monitoring their entire economies, “the potential effects of a policy chosen for a sector can be more foreseeable and less risky than for a broader approach, where the economic impacts that may occur are much less well understood.”¹²⁷

Members of an STA would also gain some of the benefits of economic interdependence without the costs of a fully liberalized trading regime. Although an STA would depart from the WTO’s general

125. PIERRE LORTIE, *ECONOMIC INTEGRATION AND THE LAW OF GATT* 175 (1975).

126. PETER ROBSON, *THE ECONOMICS OF INTERNATIONAL INTEGRATION* 198 (3rd ed. 1987). See also GHANTUS, *supra* note 38, at 41.

127. JOHN H. JACKSON, *WORLD TRADE AND THE LAW OF GATT* 245 (1969) [hereinafter JACKSON, *WORLD TRADE*].

emphasis on multilateralism and nondiscrimination,¹²⁸ such a scheme appears to be the only viable way to satisfy both the need for economic development and the desire of Arab governments to maintain control over their economic and political development. This is not to say that protectionist trade policies should be tolerated where they are politically popular. In principle, the assessment of preferential trade agreements should ultimately be judged on their overall economic effects. However, whether any increase in Middle East sectoral trade is good or bad for the global trading system should not be determined only on the trade diversion basis that Dam suggests.¹²⁹ While trade diversion is an important criterion, "[o]ne also has to look at the momentum, or the lack of it, these arrangements impart to multilateral negotiations, and ultimately to the wider trade liberalization process."¹³⁰ In addition, the benefits of sectoral preferences to the Middle East region and the world trading system would likely outweigh the costs of potential trade diversion that such a scheme might produce. This might be true because an STA strategy, analogous to a regionalist strategy, might achieve global free trade objectives faster than a multilateral approach.¹³¹ For example, El-Agraa argues that little can be done to prevent regional associations whether the world likes it or not, and that these groupings, particularly the EU, have nonetheless produced strong momentum towards greater liberalization and progress towards Article XXIV compliance.¹³²

Finally, by allowing certain STAs, the WTO might have a better chance of containing governments with different political and economic

128. "Multilateralism" embraces the view that international decisions should be made by international agreements based on broad consensus and should bind many nations. The underlying idea is that unilateral actions by single countries or among a small group of countries will erode the mutual cooperation that is necessary to keep markets open and is inequitable because only a few countries reap the benefits of a proposed action. Thus, the multilateral philosophy is most strongly reflected in the MFN clause of GATT Article I.

129. See DAM, *supra* note 40, at 275, and Dam, *Regional Economic Arrangements and the GATT*, *supra* note 88.

130. John Whalley, *Comments to Gardner Patterson, Implications for the GATT and the World Trading System*, in FREE TRADE AREAS AND U.S. TRADE POLICY, *supra* note 89, at 373.

131. Some scholars think that RTAs might bring global free trade sooner by keeping up the trade liberalizing momentum when global negotiations languish. They contend that RTAs, because they involve fewer countries, are more flexible to address problems that would otherwise take years to negotiate in global discussions. See *The Right Direction?*, THE ECONOMIST, *supra* note 41, at 23.

Of course, analysts disagree whether this contention is true. Compare Marshall A. Cohen, *Regionalism's Lure: Regionalization of Trade and Investment*, CHIEF EXECUTIVE, July, 1993, at 28, available in LEXIS, News Library, Arcnws File (stating that "the drive toward deeper regional integration is unlikely to be halted."), with *The Trouble With Regionalism*, THE ECONOMIST, June 27, 1992, at 79 (arguing that most FTA's are trade diverting).

132. El-Agraa, *supra* note 39, at 3 (noting that the EC established the common external tariff at the same time that the Kennedy Round reduced tariffs).

ideologies within the Organization's supervisory framework. This might greatly reduce the polarization and friction between capitalist and centrally planned States, exemplified by the current debate over Chinese membership in the WTO.¹³³

2. Securing Peace

Most importantly, a sectoral approach in the Middle East would effectuate the strong political purpose of securing the continuing peace process. As Professor Jackson states, "[p]robably the most important foreign policy goal related to international economic policy is the prevention of war."¹³⁴ The WTO should always consider this principle foremost because economic efficiency may not be the only goal that motivates nations to join regional arrangements, much less join the WTO. To illustrate this idea, Professor Jackson noted that "[c]losely allied nations may wish to cement [their] alliance through economic integration or . . . to enhance the stability and capacity of a particular region to defend itself."¹³⁵ Indeed, unless an RTA is successful enough to survive politically, its potential economic success will be largely irrelevant.

Surely, the European Coal and Steel Community (ECSC) is one example of what Professor Jackson had in mind.¹³⁶ The strategy of using partial economic integration as a means of producing economic development and political security was successfully used in Western Europe after World War II. In that case, France and West Germany overcame some of their political and economic differences by signing the Treaty of Paris in 1951.¹³⁷ This treaty established the ECSC, a free trade area in coal and steel products among West Germany, France, Belgium, Luxembourg, the Netherlands, and Italy.

The United States appreciated the importance of creating interdependent economic relationships to foster political cooperation as it played

133. See Ruggiero Sees "Tough Time" Ahead in China-WTO Debate, DEUTSCHE PRESSE-AGENTUR, Apr. 23, 1997, available in LEXIS, News Library, Curnws File.

134. JACKSON ET AL., *supra* note 41, at 37.

135. JACKSON, *WORLD TRADE*, *supra* note 127, at 580.

136. See Jackson, *Regional Trade Blocs*, *supra* note 87, at 122 (citing the ECSC as an example where political motivations superseded economic considerations when forming a regional association).

137. Treaty Instituting the European Coal and Steel Community, April 18, 1951, 261 U.N.T.S. 140. According to Professor Jackson, "[t]he Treaty expires in 2001 and it is expected that coal and steel products will then become subject to the EC Treaty." JACKSON ET AL., *supra* note 41, at 187, fn. 2.

an important role in the formation of the post-war European economy based on cooperation and fewer intra-European economic barriers. As Gilpin points out, "[o]f equal importance, however, was the American provision of a sense of security, not just against the Soviet Union but also with respect to the risks inherent in dismantling protectionism and with respect to the latent fear of German domination, especially on the part of the French."¹³⁸

While the primary purpose of a Middle East trade association would be to foster peaceful relations and not to coordinate a common Middle East defense policy, the historical similarities between the formation of the ECSC and the current developments in the Middle East are striking. Just as France was concerned about an industrially superior West Germany as a result of the economic aid West Germany was receiving from the United States,¹³⁹ the Arabs also fear that Israel will disproportionately benefit if there is closer economic interaction¹⁴⁰ in part because of the massive political and economic aid Israel has enjoyed from the United States. Moreover, in both situations, formerly warring nations attempt to solidify their political reconciliation by creating mutually vested economic interests in specific industrial sectors. After all, the ECSC was intended, *inter alia*, to prevent the reemergence of prewar rivalries. This was undoubtedly a subtle, but crucial, factor that GATT members considered when deciding to tolerate the limited product scheme of the ECSC.¹⁴¹

Similarly, developed countries have a strong interest in fostering both industrial development and political reconciliation in the Middle East.¹⁴² An appropriate way for developed countries to show their support would be to allow those peace-declaring countries to integrate their economies on a sectoral basis even if it does not offer the rest of the

138. ROBERT GILPIN, *U.S. POWER AND THE MULTINATIONAL CORPORATION* 107 (1975) [hereinafter GILPIN, *U.S. POWER*].

139. ARAD ET AL., *supra* note 7, at 126.

140. See *supra* Parts II.C and IV.B.

141. The ECSC was technically granted a waiver of GATT obligations under Article XXV, paragraph 5. See V.A. SEYID MUHAMMAD, *THE LEGAL FRAMEWORK OF WORLD TRADE* 252 (1958).

142. See Lubetzky, *supra* note 4, at 407 (discussing the U.S. interest in "keeping the Middle East safe"); Waugh, *supra* note 123 (explaining how "[t]ighter economic ties and increased investment in the Middle East would greatly boost the peace process."); *China Reaffirms Support for Mideast Peace Process*, XINHUA NEWS AGENCY, Oct. 29, 1995, available in LEXIS, News Library, Curnws File (China will "continue its economic cooperation with and provide assistance to countries in the region.").

WTO members any immediate economic advantages.¹⁴³ After all, as Gilpin points out, the United States reversed its earlier commitment to global multilateralism and nondiscrimination by promoting the ECSC's preference area which, in the short term, discriminated against American goods. Gilpin explains that "[a]lthough the U.S. tolerated discrimination, it also assumed that a fast-growing Europe would eventually be more trade-creating than trade-diverting."¹⁴⁴ Similarly, strong economic growth in the Middle East might foster viable industries that would allow those countries to competitively enter world trade markets, thereby integrating those countries within the region and with the rest of the world, expanding global trade. As the European experience demonstrates, sectoral integration provides a strong impetus for deeper levels of economic integration, such as a more expansive FTA.

3. Potential Sectors

To be precise, an economically beneficial sectoral agreement in the Middle East would provide tariff preferences for upstream and downstream inputs or resources used in the production process. For example, in the context of a textile agreement between Egypt and Israel, Hirsch explains that since Egypt has an obvious advantage in labor-intensive operations such as sewing, Israeli and Egyptian firms could cooperate either by subcontracting or by establishing joint ventures. Egyptian firms could take advantage of Israel's capabilities in design, printing, dyeing, and finishing. More importantly, geographic proximity facilitates communication and physical shipment of goods on short notice and at low cost.¹⁴⁵

In their 1983 analysis of the Israel-Egypt Peace Agreement, Professors Arad, Hirsch and Tovias, as well as Hirsch in a separate work, highlighted the textile and clothing sector as an example of an industry with potential complementarities between Israel and Egypt.¹⁴⁶

143. See Jurgen Huber, *The Practice of GATT in Examining Regional Arrangements Under Article XXIV*, 19 J. COMMON MKT. STUD., 281, 295 (1981).

144. GILPIN, U.S. POWER, *supra* note 138, at 108.

145. Hirsch, *supra* note 1, at 278.

146. ARAD ET AL., *supra* note 7, at 128-132; Hirsch, *supra* note 1, at 278. The Israeli clothing industry maintains a strong export performance in Western Europe and to some extent in the United States, through the establishment of the U.S.-Israel Free Trade Agreement in 1985. *Id.*

For the purposes of this note, it is not important to correctly identify the potential sectors for a regional sectoral arrangement and analyze the relative viability of each. Rather, the point here is that such an approach is a worthwhile strategy.

Complementarities also exist between Egypt and Israel in the chemical industry,¹⁴⁷ as well as among the Arab States as a whole.¹⁴⁸ Bassam Harik identified soaps, plastic, rubber, synthetics, cement, iron and steel, and aluminum as potential sectors among selected Arab States.¹⁴⁹ In addition, part of a viable integration strategy might also include cooperation agreements in energy, and transportation—areas which continue to be developed at this time.¹⁵⁰

V. AMENDING ARTICLE XXIV

The policy arguments advanced above regarding the benefits of a sectoral trade strategy underscore the need for the world trading system to address the legality of STAs. As discussed earlier, RTAs purporting to grant tariff preferences to a limited selection of industrial sectors facially violate GATT Article XXIV. In view of the above analysis, however, this note argues that Article XXIV should be amended to allow sectoral preferences in free trade areas under limited circumstances. Such an approach represents a realistic and practical compromise for the Arabs and Israelis. This approach is realistic because many analysts contend that a “legal” CU or FTA is unlikely to be formed in the Middle East.¹⁵¹ In addition, it is increasingly apparent that a system of

147. HAIM BEN-SHAHAR ET AL., *ECONOMIC COOPERATION AND MIDDLE EAST PEACE 193-94* (1989) (“Egypt’s lack of potash and Israel’s lack of domestic resources for the production of nitrogen. . . . If Egypt and Israel would pool their resources, the Israeli fertilizer industry might help Egypt to sell in the difficult but profitable markets of the Americas, Western Europe and Japan, in which Israel has developed a marketing network. . . . The diversification of market potential might possibly yield the two countries an estimated extra revenue of 1 percent.”) Hirsch also showed that:

[i]n the fertilizer industry, cooperation between Egypt and Israel can, at a minimum, entail bilateral supply arrangements covering missing ingredients: potash from Israel to Egypt and ammonia from Egypt to Israel. More ambitious schemes might consist of long-range supply contracts which may justify expansion of production capacity of ammonia in Egypt and potash in Israel, and of plants using these materials in both countries.

Hirsch, *supra* note 1, at 278.

148. GHANTUS, *supra* note 38, at 174-210.

149. Harik, *supra* note 36, at 92-118.

150. See Elaine R. Fletcher, *Israeli, Jordanian Firms Making Trade Ties; Newfound Unity to Benefit Industries*, S.F. EXAMINER, Dec. 22, 1994, at A8.

151. See Hirsch, *supra* note 1, at 281 (“even mild forms of integration such as a free trade area cannot be contemplated for the time-being”). Though she was referring to the aftermath of the Israel-Egypt peace agreement, Arad similarly claims that “[t]here is little doubt that at least in the near future these relations are going to be dominated by political considerations.” ARAD ET AL., *supra* note 7, at 117. See also Bani-Hani, *supra* note 41 (arguing that “present political and economic differences among the Arab states . . . makes [the goal of complete Arab economic unification] difficult to achieve, at least for the foreseeable future. Instead, “a gradual and regulated program of economic integration appears to be more feasible at the present time and may pave the way for complete economic unification.”).

sectoral cooperation is most likely to emerge, based on the fact that such relationships are already being established and will likely continue to be negotiated. At the same time, however, international legal issues arise because GATT forbids sectoral preferences.

In this part, section A concedes that this problem might be resolved by remedies other than amending GATT, but it nevertheless concludes that these alternative options would be inadequate. Section B suggests how GATT could be amended to allow sectoral preferences in free trade areas.

A. GATT-Based Solutions

1. Waiver

At the outset, it should be recognized that the problem at hand might be legally resolved without amending the GATT. Under the "exceptional circumstance" clause of Article XXV paragraph 5, or the "not fully comply" clause of Article XXIV, paragraph 10, the Contracting Parties¹⁵² may suspend WTO members' obligations by issuing a formal waiver of specific GATT obligations.¹⁵³ These provisions have been used to authorize several regional trade agreements, including the ECSC in 1952.¹⁵⁴ The ECSC could not qualify as a CU or FTA primarily because the duties and restrictions abolished among the participating countries applied only to coal and steel. This violates Article XXIV's requirement that a CU and FTA abolish "substantially all" duties and restrictions. Moreover, the ECSC did not establish common tariffs with respect to third countries. However, legal cover was provided under GATT Article XXV paragraph 5, which treated the ECSC as an "exceptional circumstance" and the Contracting Parties accordingly

152. In GATT/WTO style, "contracting parties" is capitalized when referring to the members of GATT/WTO when they are acting jointly under Article XXV. GATT, art. XXV, para. 1.

153. Professor Jackson labeled Article XXV, paragraph 5 as "[p]erhaps the most important single power of the CONTRACTING PARTIES . . ." JACKSON, *WORLD TRADE*, *supra* note 127, at 541. The text of Article XXV, paragraph 5 reads:

In exceptional circumstances not elsewhere provided for in this Agreement, the CONTRACTING PARTIES may waive an obligation imposed upon a contracting party by this Agreement; *Provided* that any such decision shall be approved by a two-thirds majority of the votes cast and that such majority shall comprise more than half of the contracting parties. The CONTRACTING PARTIES may also by such a vote (i) define certain categories of exceptional circumstances to which other voting requirements shall apply for the waiver of obligations, and (ii) prescribe such criteria as may be necessary for the application of this paragraph.

GATT, art. XXV, para. 5.

154. MUHAMMAD, *supra* note 141, at 252.

granted a waiver of the ECSC members' GATT Article I MFN obligations. The principle contained in Article XXIV paragraph 4, which advocates the use of voluntary economic integration to increase freedom of trade, provided the justification for this waiver.¹⁵⁵

Other examples where waivers have been granted to RTAs under Article XXV, paragraph 5 include the U.S.-Canada Automotive Products Agreement,¹⁵⁶ the Benelux Association,¹⁵⁷ the EU's Lomé Convention¹⁵⁸ and the FTA between Nicaragua and El Salvador.¹⁵⁹

Requesting a waiver, however, is an inadequate solution to the emerging situation in the Middle East for several reasons. First, there is no guarantee that the Middle East situation would qualify as an "exceptional circumstance" as required under Article XXV, paragraph 5. The "exceptional circumstance" criterion for granting waivers continually proves to be vague and unpredictable as manifested by inconsistent and unreconciled decisions by GATT's working parties.¹⁶⁰ For example, there has been no attempt to formulate a definition of an "exceptional circumstance," and as a matter of practice, a waiver will be granted simply when a GATT contracting party secures the required number of votes.¹⁶¹ To some degree, this behavior indicates that the decision to grant waivers is largely discretionary and is often times heavily influenced by the more politically and economically influential developed countries.

Second, GATT working parties are generally reluctant to grant waivers because of the fear that doing so would:

[s]et a serious precedent which could then be invoked by any contracting party. It could also encourage pressure from non-GATT countries for similar arrangements in connexion with bilateral trading agreements. Furthermore, it would constitute a serious erosion of order in international trade, as formulated in the General Agreement.¹⁶²

155. *Id.*

156. See WORLD TRADE ORGANIZATION, *supra* note 68, at 19.

157. See WORLD TRADE ORGANIZATION, *supra* note 68, at 19.

158. See ACP-EEC Convention of Lomé, Feb. 28, 1975, 14 I.L.M. 595.

159. The waiver in the Nicaragua-El Salvador FTA was granted because El Salvador was not a GATT member. MUHAMMAD, *supra* note 141, at 251.

160. See Janet McDonald, *Greening the GATT: Harmonizing Free Trade and Environmental Protection in the New World Order*, 23 ENVTL. L. 397, 464 (1993).

161. See JACKSON, WORLD TRADE, *supra* note 127, at 544. Jackson points out, though, that "a GATT Working Party suggested that it is appropriate in each case to consider whether the object sought through a waiver is consistent with the objectives of the General Agreement." *Id.* (citation to the Working Party report omitted).

162. Greece-Preferential Tariff Quotas to the USSR: Unpublished GATT Panel Report, L/3447-185/179, 1970 GATTPD LEXIS 3, at para. 11, available in LEXIS, Intlaw Library,

This concern often proves to be of the "utmost importance."¹⁶³ Third, the waiver provision stipulates that "the Contracting Parties may waive an obligation imposed upon a contracting party" which would make it inappropriate to grant a general waiver to *all* the members of an RTA such as the Middle East.¹⁶⁴ In addition, the broad and flexible authority of the waiver provision has led many Contracting Parties to view its application with concern and apprehension due to its potential use as a *de facto* amendment power to the GATT.¹⁶⁵ Furthermore, past working parties have considered, if not required, adverse economic conditions such as an unfavorable balance-of-payments situation to justify granting a waiver.¹⁶⁶ If this is the case, then it is doubtful whether the Middle East would qualify, because its balance-of-payments situation is not so dire.¹⁶⁷

Assuming *arguendo* that a waiver were granted, it could have only "limited duration"¹⁶⁸ and would be subject to annual review by the WTO Ministerial Conference.¹⁶⁹ It is evident, however, that an STA, as proposed in this note, might require several years of implementation alone, and several more years for its desired benefits to take effect. Additionally, as Professor McDonald points out, "even if a waiver is granted, the Contracting Parties may direct the party receiving the waiver to compensate other

GTTWTO File (denying Greece's application for an Article XXV waiver with regard to its 1969 Special Protocol with the USSR which provided for special tariff treatment of certain products imported from the USSR within specific quota limits).

163. *Id.* at para. 13.

164. GATT, article XXV, para. 5 (emphasis added).

165. See Douglas J. Caldwell, Note, *International Environmental Agreements and the GATT: An Analysis of the Potential Conflict and the Role of a GATT "Waiver" Resolution*, 18 MD. J. INT'L L. & TRADE 173, 190 (1994).

166. See Greece-Preferential Tariff Quotas to the USSR, *supra* note 162, at para. 15. GATT working parties have instead recommended that the countries extend tariff concessions on an MFN basis as a substitute to granting a waiver of obligations. See *id.* at para. 13.

167. *The Economist* recently reported that although Israel's trade balance showed a \$10.2 billion deficit and a current account deficit of \$2.6 billion in the third quarter of 1995, its GDP and industrial production have grown 7.9% (1995 third quarter) and 10.5% (May, 1995) respectively. Moreover, Israel holds \$8.2 billion in foreign reserves, up 6.8% from 1995. *Emerging Market Indicators*, THE ECONOMIST, Feb. 10, 1996, at 112.

The Arabs' balance-of-payments situation is unclear. Some reports indicate that Gulf States have recently experienced a decline in their payments deficit, *Higher Oil Prices Ease Gulf Payments Deficit*, AGENCE FRANCE PRESSE, Jan. 6, 1996, available in LEXIS, News Library, Curnws File, while other reports suggest that many Arab States still face serious economic problems, *Arab Economies Seen Disappointing Despite Reforms*, AGENCE FRANCE PRESSE, June 5, 1995, available in LEXIS, News Library, Curnws File.

168. Greece-Preferential Tariff Quotas to the USSR, *supra* note 162, at para. 15.

169. WTO, *supra* note 8, Article IX, para. 4. Under the WTO Agreement, waivers are now generally meant to apply for one year, and may be extended upon continuous evidence of "exceptional circumstances." *Id.*

parties who are adversely affected by it.”¹⁷⁰ This would, of course, defeat the purpose of such a scheme in the first place. Finally, pursuing a waiver is objectionable on the ground that it would subject the future of Middle East peace and economic development to the mercy of the free trade regime—a consideration that many Arab countries would most assuredly find unacceptable in view of their historical reliance on state-centered development strategies.

2. The Enabling Clause

The Middle East situation might also be resolved under the guise of the so-called “Enabling Clause.”¹⁷¹ During the Tokyo Round negotiations in 1979, GATT members legalized the extension of preferences by developed GATT members to developing countries, and also provided a safe harbor for certain kinds of trade arrangements between developing countries.¹⁷² However, the clause states that such arrangements should aim to facilitate trade, should not create obstacles to the trade of third countries, and should not impede MFN-based trade liberalization.¹⁷³ Consequently, trade concessions such as the Generalized System of Preferences (GSP) are covered,¹⁷⁴ and RTAs among LDCs are thus subject to somewhat lesser constraints under the Enabling Clause than RTAs among developed countries under Article XXIV.¹⁷⁵ For example,

170. McDonald, *supra* 160, at 464.

171. Formally entitled, Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries, GATT B.I.S.D. (26th Supp.) at 203 (1980) [hereinafter Enabling Clause].

172. *Id.* at paras. 1–2. Specifically, the clause includes a number of provisions that permit GATT’s contracting parties to grant “differential and more favourable treatment” to “developing” countries notwithstanding the MFN requirement of Article I. *Id.* See generally Abdulqawi A. Yusuf, *Differential and More Favorable Treatment: The GATT Enabling Clause*, 14 J. WORLD TRADE L. 488 (1980) (summarizing the effect of the Enabling Clause on GATT). Yusuf argued that “the principal of differential treatment is based on the idea that equal treatment of unequals is unjust and that the same rules can therefore not apply to countries at different stages of development.” *Id.* at 492.

173. Enabling Clause, *supra* note 171, at para. 3.

174. The GSP allows, but does not require, developed countries to grant duty-free treatment or other non-reciprocal tariff preferences to products originating from developing countries for a trial period of ten years. Contracting Parties to the General Agreement on Tariffs and Trade, *Generalised System of Preferences*, Decision of June 25, 1971, B.I.S.D. (18th Supp.) at 25 (1972). The GSP is intended to compensate for the developing countries’ competitive disadvantages and to facilitate their industrialization. According to Bartram Brown, “[w]hile most of the industrialized countries have established GSP preference schemes since 1971, each country’s scheme is different, and many are quite complicated.” Bartram S. Brown, *Developing Countries in the International Trade Order*, 14 N. ILL. U. L. REV. 347, 362 (1994) (footnote omitted).

175. With regard to preferences among developing countries, the Enabling Clause states that:

Regional or global arrangements entered into amongst less-developed contracting parties for the mutual reduction of elimination of tariffs and, in accordance with

the clause applies only to tariffs, although "the preferential removal of nontariff barriers still requires Article XXIV coverage or a waiver."¹⁷⁶

In practice, the Enabling Clause has proved to be a continuing source of legal confusion among GATT Members. On one hand, as Low points out, the Enabling Clause states that industrial countries do not expect to receive reciprocal commitments from developing countries that are inconsistent with the latter's individual development, financial and trade needs.¹⁷⁷ Yet on the other hand, the clause also states that developing countries expect to participate more fully in the GATT framework as their development and trade situations improves.

Confusion also derives from the fact that the Enabling Clause does not contain any reference to Article XXIV. This omission makes it unclear whether the clause applies in situations where Article XXIV does not, whether the clause affects the terms of Article XXIV's application, or whether it provides LDCs with an alternative to Article XXIV altogether. Indeed, opinion differs as to whether the Enabling Clause provides a sufficient legal basis for all regional agreements among developing countries or whether it was not intended to cover arrangements that, up to 1979, would have been handled exclusively under Article XXIV.¹⁷⁸

Until these crucial issues are resolved, applying the Enabling Clause to a Middle East common market is legally tenuous. First, it is unclear whether the "substantially all" requirement under Article XXIV, paragraph 8 would apply to a future Middle East trade agreement should one arise. Second, it is unclear whether the Middle East nations would count as qualified parties under a literal reading of the Enabling Clause because it is uncertain which development categories the countries would fall into. For example, would Israel be considered a "less-developed," "developed," or "developing" country? This determination would greatly affect whether or not Israel would legally be able to grant "differential and more favourable treatment" to its Arab peace agreement partners.¹⁷⁹ Finally, while it is true that GATT Contracting Parties have historically "maintain[ed] a higher degree of tolerance" towards developing

criteria or conditions which may be prescribed by the Contracting Parties, for the mutual reduction or elimination of non-tariff measures or products imported from one another.

Enabling Clause, para. 2(c).

176. Low, *supra* note 62, at 150. Eleven RTAs have invoked the Enabling Clause as legal cover for their agreements. WORLD TRADE ORGANIZATION, *supra* note 68, at 88-89.

177. Low, *supra* note 62, at 151.

178. *Id.*

179. The United States articulated a similar concern regarding the application of the Enabling Clause to Mercosur. See Francis Williams, *GATT Row Brews on Mercosur Scrutiny*, FIN. TIMES, July 14, 1992.

countries' RTAs,¹⁸⁰ the same might not be true in the future with the promulgation of the WTO's Understanding on Article XXIV. Thus, a new and more precise legal cover should be explicitly provided to a Middle East RTA.

B. Amending the GATT

This note argues that amending the GATT to allow sectoral preferences is a more legally acceptable solution. Such an amendment would recognize that Article XXIV is simply unresponsive to both the global economic interest as well as facilitating the Middle East peace process. Because Arab States have historically resisted integrating their economies into the world economy and are likely to resist such initiatives in the future,¹⁸¹ an across-the-board tariff reduction is an unrealistic strategy for their economic and political development. Even if the Arabs decided to radically liberalize their trading regulation towards Israel, it would certainly not be likely to occur within the suggested ten year period that GATT now permits regional blocs to fulfill their Article XXIV requirements.¹⁸²

Even though this note is written primarily as a policy analysis with its primary goal to persuade WTO members to formally permit sectoral preferences in FTAs, it is nevertheless useful to briefly outline what such an amendment might look like. Despite the inherent difficulty of amending the GATT,¹⁸³ this note proposes adding a paragraph to Article XXIV that would provide legal cover for sectoral trade schemes among nations that fulfill certain narrow criteria.

First, this new paragraph would apply to sectoral trade agreements only among less and least developed countries, nations that have historically exercised State control over their national economies, and nations that have been at war, or otherwise economically detached. The sectoral preference safe-harbor would not apply to developed countries unless they wish to establish economic relations with LDCs with which they have been at war or have been economically detached. This requirement reflects the purposes of several international legal instruments discussed throughout this note: the Enabling Clause's purpose to assist LDCs in their development, as well as the strong peace-promoting function of

180. See Wechter, *supra* note 44, at 2619.

181. See Thomas L. Friedman, Editorial, *Arab World Likely to Miss Train to Global Economy*, ROCKY MOUNTAIN NEWS, Oct. 19, 1995, at 53A, available in LEXIS, News Library, Curnws File.

182. See *supra* note 66 and accompanying text.

183. Under GATT Article XXX, amendments to the GATT require the unanimous consent of the contracting parties if applied to Article I. In addition, such amendments are effective only with respect to those contracting parties accepting it. GATT, art. XXX, para. 2.

international trade agreements as embodied in the ECSC and the WTO. For example, possible beneficiaries of this paragraph might someday include, in addition to the Arabs and Israelis, North Korea and South Korea, Iran and Iraq, and Pakistan and India.

Second, the countries forming an STA would be required to cut their internal tariffs to the lowest level of any member *within those specific sectors*. This would achieve a sensible and realistic development strategy, while guaranteeing at least some external liberalization within that sector.

Third, STA countries would also be required to notify the WTO before signing any sectoral agreement. Notification will enable working parties to deliberate and review the agreement before it is initialed, thereby ensuring an opportunity to suggest changes to the agreement, if necessary. For example, a working party could suggest measures that would reduce foreseeable trade diversion and encourage the STA to adopt liberal accession clauses, such as those used by NAFTA.¹⁸⁴ Also, working parties could monitor the STA every few years to evaluate the extent of trade diversion, as well as the progress of economic development within the member countries, and, where applicable, their progress in securing peaceful relations. However, with respect to the trade diversion issue, the working party should consider whether the trade diversion, if any, is justified by legitimate political or economic purposes, or is reasonable under all the circumstances, and whether it is no more restrictive than necessary.¹⁸⁵

Fourth, STAs would eventually have to be open-ended to allow other similarly situated countries to join the arrangement as soon as they are able to assume the level of obligations observed by existing member countries. For instance, countries that are not members of a future Middle East STA might later request that the association reduce the tariffs on those products whose export into the association would otherwise be displaced. This approach would encourage multilateral market-access negotiations with the Middle East STA, thereby progressively integrating the association with the rest of the world in the long term.

Little, if any, academic literature currently advocates a similar proposal. Most Article XXIV commentators acknowledge the Article's shortcomings, but instead propose that stricter review mechanisms, discipline, and supervision would be adequate solutions.¹⁸⁶ However, this

184. North American Free Trade Agreement, Dec. 14, 1992, art. 2204, 32 I.L.M. 605.

185. This test is adapted from the GATT's jurisprudence in the environmental context. See Robert L. McGeorge, *The Pollution Haven Problem in International Law: Can the International Community Harmonize Liberal Trade, Environmental and Economic Development Policies?*, 12 Wis. INT'L L.J. 277, 343 (1994) ("[t]rade restraints must be no more restrictive than necessary to accomplish the environmental objectives.") (footnote omitted).

186. See Jackson, *Regional Trade Blocs*, *supra* note 87, at 129-30.

note is skeptical as to whether these efforts would seriously improve Article XXIV's effectiveness in simultaneously promoting regional free trade while minimizing inefficient trade diversion. Furthermore, the desire of so many countries to join illegal RTAs seems to indicate a stubborn collective action problem for which the WTO appears to lack enough political influence to solve at the present time. What makes matters worse for improving Article XXIV is that the nation least willing to change Article XXIV will ultimately determine the pace of any future negotiations.¹⁸⁷

Accordingly, this note suggests that adding a sectoral trade provision to Article XXIV would create mutually beneficial arrangements which would likely serve as a precursor to more general free trade agreements—a process that increases global economic efficiency in the long term.

CONCLUSION

This note addresses a potentially compelling legal problem: the issue of securing political and economic development in the Middle East with the aid of the multilateral trading system. On one hand, an STA would best secure the Middle East peace process because it will likely lead to mutually beneficial economic growth which will create vested interests in continued political and economic cooperation. On the other hand, such a scheme would facially violate GATT's regional trade area rules. Thus, as a middle road, this note argues that the GATT should allow such limited product schemes for countries meeting certain requirements.

Article XXIV, in its current form, might work against promoting peace in some of the most intractably war-stricken regions of the world. Amending Article XXIV could solve this problem because sectoral arrangements can serve as a means to achieve "eventually all" free trade among those countries in the long term, provided those members eventually phase-in lower barriers against imports from other countries and that they remain open to all similarly situated countries willing to join on the same terms.¹⁸⁸

The limitation of the sectoral strategy model is primarily a practical one: it requires extensive multilateral action for its implementation, and it may be difficult to build the necessary consensus to select the industries that will receive preferential treatment. Nevertheless, while the sectoral approach might pose trade diversion problems, it represents a sensible and realistic policy to build a lasting and meaningful peace in the Middle East. Surely, this factor is vital to the future political and

187. See Wonnacott & Lutz, *supra* note 116, at 66–67.

188. *Battle Lines*, *supra* note 41, at 13.

economic security of the region and the rest of the world. In addition, this note argues that denying nations the right to form preferential associations, particularly when the motivation behind their creation is often political rather than economic, does not serve the best interests of the world trading system.

The proposed amendment to allow sectoral preferences under certain conditions would not significantly affect the prestige of the WTO as the rule of law and as the forum for multilateralism in international economic relations. To the contrary, such a limited amendment should be viewed as a better method to achieve global free trade in the long term. So long as economic growth and peaceful relations are maintained, Middle East nations would eventually have good reason to integrate with the rest of the world. While sectoralism and regionalism pose some risks on the global multilateral system that the WTO espouses, on balance they are constructive tools to promote democratic institutions, market-oriented economies, and most importantly, to prevent regional wars. The WTO should provide the institutional surveillance, leadership and political support needed to accomplish these goals.