JOB(05)/268 28 October 2005

Negotiating Group on Rules

DISCUSSION PAPER ON REGIONAL TRADE AGREEMENTS

Paper by Norway

1. The mandate of the Negotiating Group on Rules directs the Members to "negotiations aimed at clarifying and improving disciplines and procedures under the existing WTO provisions applying to regional trade agreements".[1]

2. This paper is a contribution to the discussion related to the concept of "substantially all the trade" in GATT Article XXIV:8 and the role that this concept should have in regional trade agreements ("RTA"). It is presented with the intention to promote and broaden the discussion and is not a negotiating proposal. The paper could be further developed and supplemented by additional contributions in the future. This submission does not address similar issues related to the concept of "substantial sector coverage" in GATS Article V.

I. PURPOSE OF EXERCISE

3. GATT Article XXIV recognises the positive contribution regional trade agreements can give in support of the multilateral trading system, and the expansion of world trade that may be made by closer integration between the parties to such agreements. At the same time, as an exception to the fundamental MFN principle, there is a need to ensure that such agreements have the requisite scope of economic integration to allow derogations from the MFN principle.

4. There is a need for improved disciplines and procedures. A number of regional trade agreements have been stalled in the CRTA without the committee finalising the reports, due to disagreements over coverage.

5. Clarifying and/or improving the disciplines relating to "substantially all the trade" may be useful. This can:

(a) be a "tool" to ensure predictability for trade negotiators so that they can assess – as they negotiate – whether their draft RTA fulfils the requirements; and

(b) provide a "tool" to assist the CRTA in evaluating whether agreements under GATT Article XXIV has the coverage and the provisions necessary to fulfil the requirements for MFN exception.

6. At the same time it is important to ensure that any new disciplines provide appropriate flexibilities to cater for the situation of developing countries.

[1] Doha Declaration, paragraph 29.

II. A "HOLISTIC APPROACH" TO ASSESS THE FULFILMENT OF THE REQUIREMENTS OF GATT ARTICLE XXIV:8

7. GATT Article XXIV:8 provides in relevant parts that the covered RTAs must fulfil the requirements that

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

8. GATT Article XXIV:8 thus directs any RTA to fulfil the following two criteria that merit clarification or improvement:

(a) What is the <u>trade coverage</u>[2] required to fulfil the "substantially all the trade" (SAT) criterion *per se*? This is primarily but not exclusively a quantitative measurement.

(b) What is the <u>treatment</u> required of the RTA in respect of SAT – i.e. how to interpret and apply the criterion of elimination of both duties and other restrictive regulations of commerce?

9. Additionally there are two temporal dimensions:

(a) At what point in time and with what data should the assessment of fulfilment take place? and

(b) What is the maximum length of phasing-in that should be permitted, including any guidelines on staging of the phasing-in and any exception to the maximum length?[3]

10. All these elements combined constitute the "tool" to give guidance regarding whether a RTA fulfils the requirements of GATT Article XXIV. One or the other of the elements is not necessarily decisive in and of itself.

III. WHAT IS "SUBSTANTIALLY ALL THE TRADE" ("SAT")?

11. "Substantial" does not mean "all", but denotes a certain magnitude. As a "legal standard" it is normative and qualitatitive and thus open to judgement. Webster's New Collegiate Dictionary defines it as "considerable in quantity", "sufficiently large" and "being largely but not wholly that which is specified".[4] Together with "all" in "substantially <u>all</u>" we are inclined to think that it should

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[2] Additionally the preamble to the "Understanding on the interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994" makes reference to the trade coverage of such agreements when:

> "Recognizing also that such contribution [to the expansion of world trade] is increased if the elimination between the constituent territories of duties and other restrictive regulations of commerce extends to all trade, and diminished if any major sector of trade is excluded".

[3] The time limit in paragraph 5 (c) of GATT Article XXIV refers to a "reasonable length of time". This has been developed further in the "Understanding on the interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994", where paragraph 3 provides that:

> "The 'reasonable length of time' referred to in paragraph 5(c) of Article XXIV should exceed 10 years only in exceptional cases. In cases where Members parties to an interim agreement believe that 10 years would be insufficient they shall provide a full explanation to the Council for Trade in Goods of the need for a longer period."

[4] Webster's New Collegiate Dictionary (1976) at page 1161.

be far more than half the trade, perhaps more than [X] of the trade. The exact level is not clear today, and any setting of a precise threshold would have to be negotiated and would go beyond a mere clarification of current GATT Article XXIV.

12. The "trade" that has to be substantial cannot be viewed by merely counting tariff-lines. A Member, in its proposal to establish coverage of 95 per cent of the tariff lines at HS 6-digit level as a threshold[5], refers to the need to supplement this methodology with qualitative elements.

13. Rather than only counting tariff lines at 6-digit level, one should evaluate whether this methodology should or should not be supplemented by reference to current trade patterns between the parties to the RTA, i.e. by reference to whether the agreement at its entry into force covers [X] of current trade by value. In this paper the term "trade coverage" is subsequently used as a short description for tariff lines and/or trade value.

14. Some Members have suggested that trade coverage at the end of the phasing-in period for a RTA is the appropriate benchmark. While an agreement certainly is supposed to open up for trade expansion, it is difficult to measure in any objective and verifiable way how the opportunities that a RTA creates will actually be utilised. Concessions may cover products that for various reasons are not traded much more after the entry into force of the RTA as compared to before its entry into force, e.g. that elimination of the duty in question is of limited significance. Macro-economic developments can also change the competitive relationship and affect the utilisation of trade opportunities. Furthermore, imports from other sources affect the competitive situation of the RTA imports. It may therefore be difficult to separate the effects of tariff dismantling.

15. Predictability for the RTA-partners as they negotiate, furthermore, dictates that such "trade opportunities" cannot be given precise weight in assessing SAT coverage. Since negotiators need to be able to assess before finalising the RTA that it actually covers SAT, it would seem that "trade opportunities" may be assessed in terms of the general coverage of tariff lines and not in terms of the value of future trade.

16. An additional qualitative element to be discussed when assessing "trade coverage" is whether there should be a requirement that all major sectors are covered. The concept of "major sectors" is not referred to as a requirement in GATT Article XXIV:8, but the desirability of covering all major sectors is referred to in the preamble to the "Understanding on the interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994".[6] As preambular language it cannot override or contradict the treaty text itself, but it may be given interpretative value.

17. At the outset it would seem difficult to apply "major sectors" as a decisive factor. This is because of difficulties in establishing what constitutes separate sectors. Is "fish and crustaceans, molluscs and other aquatic invertebrates" (HS chapter 3) one sector? Is agriculture to be counted as one or 23 sectors, as it covers approximately 23 HS chapters? Is nuclear power generation (sub-chapter 84.01) one sector or a part of a "machinery sector"?

18. Furthermore, even if one were to agree to consider e.g. each HS chapter as one sector it could be difficult to assess the situation as RTA partners may have excluded or only partially liberalised certain tariff lines at 6, 8 or 10 digit level. If new interpretations or precisions to the criteria in GATT Article XXIV:8 are adopted, with measurements of trade coverage based on actual trade value and coverage of tariff lines at 6 digit level, there does not seem to be a need to give separate weight to this concept from the 1994-understanding.

[5] TN/RL/W/173 paragraph 6, and TN/RL/W/180 paragraph 4.

[6] See footnote 2.

19. The question of whether the relationship to a regional integration agreement should have an incidence on the SAT requirement, ref. GATS Art. V:2, is not further discussed in this paper.

IV. TREATMENT TO BE GIVEN TO THE TRADE COVERED BY A RTA.

20. Once trade coverage is established the next group of questions relate to the treatment that GATT Article XXIV:8 requires in respect of SAT. For the MFN-exception to be permissible, GATT Article XXIV:8 establishes requirements relating to both "duties" and to "other restrictive regulations of commerce" (ORRC).

21. As GATT Article XXIV applies to both duties and ORRC, both elements must be tested in respect of fulfilment of the SAT criterion. Any test that applies to only one side of the criterion would undermine the existing "double" criterion, and must be avoided. Testing of the required second element (ORRC) is a neglected part in most RTAs entered into as well as in the discussions so far in the Negotiating Group on Rules.

22. Regarding duties, GATT Article XXIV:8 puts emphasis on "elimination" . Elimination of duties is one central element, and the trade coverage subject to full liberalisation is an important factor. By elimination one understands elimination in full. A partial reduction of any particular rate of duty would not meet the SAT criterion.

23. In addition to elimination of duties, GATT Article XXIV:8 requires that Other Restrictive Regulations of Commerce (ORRC) – other than those specifically mentioned – be eliminated on substantially all the trade. The question is both which are these ORRC's that are to be eliminated, and how does one fully evaluate such ORRC?

24. To avoid undermining the SAT obligation, as a point of departure, corresponding requirements could be made to those that are applied to duties. Where products or tariff lines are or may be subjected to such ORRCs in the future, then these specific products or tariff lines fail the test of GATT Article XXIV:8. Furthermore, where some but not all trade restrictions are removed, the products or tariff lines affected should not be fully counted towards the SAT criterion.

25. Both Articles XI and XIII of the GATT (concerning quantitative restrictions) are among the exceptions to ORRC permitted to be continued under GATT Article XXIV:8. However, to the extent that a quantitative restriction is maintained for products where restrictive regulations otherwise e.g. duties, are eliminated, the question arises how such less than full liberalisation should be counted towards the SAT criterion. Even though quotas are to a certain degree maintained, such quotas combined with duty elimination could still give an important contribution to trade liberalisation between RTA-partners. Instead of completely disregarding this as one Member seems to suggest, one could discuss whether such less than full liberalisation could be given a certain weight, but that weight would be less than where there is total elimination of restrictive regulations.

26. ORRCs are not defined positively in GATT Article XXIV:8, which only lists the exceptions. The discussion regarding those that are to be eliminated has so far primarily centred on safeguards, anti-dumping measures and countervailing duties ("CVD") import licences, rules of origin and standards (TBT/SPS).

27. Members have been split on the issue of whether RTA-partners must be, or may be, excluded from global safeguards. The current state of that discussion is reflected in the last sentence in footnote 1 to the *Agreement on Safeguards (ASG).*[7] Where the RTA does not exclude the use of global safeguards, a question arises as to how the trade coverage to which such global safeguards may be applied, should be regarded in relation to the SAT criteria.

28. Another ORRC to be eliminated is anti-dumping measures. Some RTAs include provisions that do not permit anti-dumping measures to be applied between the parties. This can be viewed as a logical consequence of the wording of GATT Article XXIV itself, including the desirability to achieve closer integration between the economies of the parties. Similar arguments can also be made in respect of countervailing duties (CVD) and import licences. Even if CVDs are not applied, the remaining remedies of the *Agreement of Subsidies and Countervailing Measures* (ASCM) could be available, including consultations and dispute settlement for injurious subsidies. The same argument made in respect of global safeguards regarding counting against the SAT requirement applies to anti-dumping measures, CVD and import licences.

29. A lot of time has been spent discussing whether preferential rules of origin are to be considered an ORRC, as such preferential rules sometimes have the effect of directing the partners to use input factors from the other partner or from other specified sources. All Members seem to agree that RTAs need rules of origin to establish the scope of products covered by the RTA and their precise origin, in particular as long as general rules of origin have not been agreed to. Indeed this is also established by paragraph 8 of GATT Article XXIV and its reference to “products originating in such territories”. If preferential rules of origin are too restrictive and too difficult for exporters to adhere to, then the actual trade between the RTA partners will be lower – possibly not achieving the required coverage of SAT. If this is the case, then the question arises whether particular preferential rules of origin need to be adjusted.

V. TEMPORAL ELEMENTS

30. The general maximum limit of 10 years for phasing-in of liberalisation is established in the “Understanding on the interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994”, paragraph 3.[8] There is no need to change this provision. Within this outer limit it is for the parties to the RTA to negotiate the appropriate phase-ins. Rather than for the WTO-rules to put in place particular quantitative or qualitative mid-point requirements, this should be viewed flexibly with due regard to the particularities of each and every case.

31. Where there is a phase-in period for certain products, fulfilment of SAT etc. must be assessed not only in light of trade coverage at the entry into force, but must take into account the resulting market openings at the end-point.

32. Some Developing Members have pointed to the exceptions clause in the “Understanding on the interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994”, paragraph 3, and suggested that this exception only be available to Developing Members. This could be further looked into.

[7] Footnote 1 to the Agreement on Safeguards reads in pertinent parts:

> “[...] Nothing in this Agreement prejudges the interpretation of the relationship between Article XIX and paragraph 8 of Article XXIV of GATT 1994."

[8] See footnote 3.

VI. OVERALL ASSESSMENT OF WHETHER THE CONDITIONS FOR THE MFN-EXCEPTION EXIST

33. The holistic approach suggested above implies that normally no single factor will have decisive weight on its own, but rather it is the total assessment of tariff and ORRC-elimination as supplemented by the other elements that gives guidance. This does not exclude that some factors are more decisive than others. Low coverage of tariff lines and/or trade for which duties are eliminated and lack of elimination of ORRCs are all elements that would indicate that a RTA does not fulfil the requirements in GATT Article XXIV:8.

34. Some Members have suggested that the fulfilment of the requirements of GATT Article XXIV:8 should be assessed individually for each party to the RTA. This seems to be a sound approach, as the requirements of GATT Article XXIV:8 are applicable to each individual Members and not a question of collective fulfilment of the parties to a RTA.

35. RTAs where a developing country is one of the parties, can be asymmetric in the sense that the developing country partner can liberalise less and at a lower speed than the developed member. The standard set for "north/north" RTAs should therefore be relaxed for developing country participants in "north/south" RTAs as well as for "south/south" agreements. The clarification of SAT should make clear that such practise should be allowed to continue.

36. Finally one cannot lose sight of the fact that any clarifications or improvements agreed in this round may result in a new interpretation of Article XXIV that is different from the interpretation Members employed when they negotiated RTAs that are already entered into. Automatic application of new disciplines to old agreements does not seem viable or appropriate; while at the same time new disciplines should apply from the entry into force of new agreements. Consequently, in respect to existing agreements there is a need to look at "grand-fathering" or transition periods for some or all the elements. The exact solution, however, is better left for later negotiations when first the substantive new requirements have been negotiated.

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