# WORLD TRADE ORGANIZATION

RESTRICTED

**TN/RL/M/24**
23 March 2005

(05-1223)


**Negotiating Group on Rules**

## SUMMARY REPORT OF THE MEETING HELD ON 7 MARCH 2005

Note by the Secretariat

1. The Negotiating Group on Rules ("the Group") held a formal meeting on 7 March 2005.

A. ADOPTION OF THE AGENDA

2. The Group adopted the following agenda:

   A. Adoption of the Agenda

   B. Regional Trade Agreements (RTAs)

   C. Other Business

B. REGIONAL TRADE AGREEMENTS

3. The Chairman proposed that the Group consider, on a preliminary basis, the proposal just made by Australia and circulated as TN/RL/W/173 (TN/RL/W/173/Rev. 1 in its English version). This would allow the Group to revive its discussion on systemic issues on the basis of a proposal by a Participant.

4. The proponent stated that his delegation was pleased to present its submission on the definition of "substantially all the trade" (SAT). GATT Article XXIV provided an exception to the most-favoured-nation (MFN) rule, which was the central pillar of the multilateral trading system (MTS). As it was known, this exception was based on the assumption that genuinely liberalizing preferential trade agreements were building blocks for global free trade. To ensure that RTAs were genuinely liberalizing, GATT Article XXIV contained various tests, which included the requirement that an RTA eliminated duties on "substantially all the trade" between the parties. Unfortunately, the lack of clarity and common understanding on the meaning of SAT had led to enormous diversity in the tariff-line and trade coverage of RTAs. Some Members had entered into RTAs that excluded entire sectors or their number one export; other Members had entered into RTAs with extremely limited tariff-line coverage on the basis that bilateral trade was highly concentrated and the agreement covered most of this trade. Doubts existed on whether the SAT test, in its current form, could fulfil its intended role as a guarantor of genuinely liberalizing RTAs; these were reflected in the recent Sutherland report on the Future of the WTO, which had pinpointed the lack of definition in the SAT provision as a major systemic weakness in the MTS architecture. In his delegation's view, Members should seize the opportunity presented by the Doha Round to create a clear, objective benchmark to assess whether their own and others' RTAs were consistent with WTO commitments. The submission proposed a two-pronged quantitative test for assessing whether an RTA had eliminated duties on SAT, as required by GATT Article XXIV. The first prong involved the application of a tariff-line coverage test. In particular, duties would have to be eliminated on at least 70 per cent of tariff lines at the

Harmonized System (HS) six-digit level on the RTA's entry into force, and at least 95 per cent of tariff lines after ten years. The second prong involved the application of a trade test. This aimed to minimise the risk that "highly traded products", and products that would be subject to greater trade between the parties in the absence of protectionist measures, be among the tariff lines exempted from elimination. In particular, Members would be prevented from excluding lines from tariff elimination where the value of imports from the other RTA party or parties exceeded a fixed percentage threshold. His delegation had suggested a figure of two per cent for this purpose. Also, the overall export trade of the RTA parties on exempted lines would be analysed during the examination process. His delegation was open to Members' views on how these ideas could be further developed. The two-pronged test for SAT would apply to all RTAs under GATT Article XXIV. It was his delegation's belief that the proposed test was sufficiently ambitious and robust to safeguard the MTS integrity. At the same time, the proposed percentage thresholds, and the implementation timeframe of ten years, provided some flexibility in recognition of the reality that Members might exclude some highly sensitive product lines from tariff elimination. There was a need for an ambitious and robust discipline under Article XXIV to ensure that RTAs supported, rather than undermined, the MTS. His delegation was open to suggestions on how to further develop the proposal on setting an objective measure of SAT, and looked forward to working constructively with all Members towards concrete outcomes under this important systemic aspect of the Doha mandate.

5. Participants thanked the proponent for having made the submission that would allow the Group to revive the debate on systemic issues; they highlighted the preliminary nature of their comments, given the late arrival of the proposal. Participants acknowledged that arriving at more precise definitions for key issues such as SAT was an important part of the Group's mandate during these negotiations.

6. It was generally noted that RTAs having wide coverage and high quality disciplines helped the MTS. Various Participants underlined the primacy of the MTS, and that RTAs complemented and were building blocks to further multilateral trade liberalization. It was also noted that negotiations at the multilateral level for the trade liberalization of sensitive sectors or the establishment of disciplines was facilitated if these issues had already been dealt with in regional and bilateral trade agreements.

7. While a number of Participants welcomed the two-pronged approach proposed, others observed that developments in the MTS had shown the need for flexibility rather than for rigidity, in particular in light of the unique nature of each RTA. One Participant noted that, though the SAT requirement already set a fairly clear legal standard, some Members had used "the lack of clarity" of WTO rules as a pretext for justifying RTAs which fell short of meeting the requirement; while each RTA was unique, the rules of Article XXIV of GATT 1994 did not differentiate between various types of FTAs or customs unions.

8. Participants listed a number of objectives pursued in the negotiations. First, a more precise definition of the concepts included in Article XXIV of the GATT 1994 and GATS Article V would help Members embarking in RTAs negotiations to be aware of what was expected from them, while at the same time allowing WTO Members to better assess the degree of liberalization of RTAs. Second, negotiations should aim at ensuring accountability with regard to all RTAs. Third, a redefinition of the CRTA's role would be needed so that it would no longer be required to determine an RTA's consistency with the WTO rules. As regards procedure, it was suggested that the Group should first focus its work on the tools, and related technical issues, to be used in defining SAT, leaving the discussion regarding precise benchmarks for a later stage. Finally, one Participant noted that the SAT clarification would not involve a new commitment but, rather, simply defining more clearly an existing one.

9. Divergent views were expressed regarding the proposed benchmarks. Participants supporting them highlighted the need for ensuring that RTAs were based on ambitious standards, as only high

quality RTAs could positively contribute to the MTS; they expressed concern with requests for flexibility that would dilute existing requirements. One Participant stated that while ideally an RTA should reach 100 per cent trade coverage, that was not always practical; therefore, the proposal set a useful and pragmatic element for defining SAT. It was noted that the 95 per cent benchmark would allow for certain sectors to be carved out from an agreement; thus, the inter-related test on "highly traded" products was especially important to ensure that such a situation would not occur.

10. A number of other Participants questioned the need for defining such ambitious benchmarks; in their view, a SAT definition through quantitative benchmarks should be based on attainable and reality-based standards, including the differentiation between industrial and agricultural products. They highlighted the need for finding a balance between too rigorous benchmarks – which would seriously limit the number of qualifying RTAs, thus posing a problem to many existing RTAs and frustrating the establishment of future RTAs – and too generous ones – which would result in a proliferation of RTAs that might undermine the MTS. One Participant noted that reality-based standards should also permit the exclusion of sectors or at least some major sector from trade liberalization, while another Participant proposed to reduce the final liberalization benchmark to 90 per cent of the tariff lines. The point was also made that a SAT definition that would result in preventing the formation of RTAs would be contrary to Article XXIV:5 of the GATT 1994.

11. Technical clarifications were requested on the use of six-digit tariff lines. It was noted that RTAs used a variety of tariff levels; measuring RTAs' coverage on a single basis might not provide an accurate result. Another major question would be how to deal with those six-digit tariff lines that were only partially liberalized. It was therefore suggested that information be provided at the same level of disaggregation as that used in the RTA, and that a more detailed discussion on that be held at a future meeting. Clarification was also sought on how the proponent defined exclusion from trade liberalization in the context of paragraph six of the submission, in particular whether the existence of tariff-rate quotas would mean that the product was excluded from coverage.

12. Divergent views were expressed on the use of a tariff-line instead of a trade benchmark. One major identified risk was that the use of a tariff-line benchmark could result in situations where substantial coverage existed in terms of tariff lines, but not in terms of traded products. In particular, it was noted that such an approach would not be appropriate for cases where intra-trade was concentrated on a relatively small number of products. Further, the point was also made that a tariff-line approach might be burdensome and considerably limit flexibility regarding RTAs' product coverage. In light of these problems, some Participants proposed that SAT be defined in terms of the percentage of trade covered or both the percentage of tariff lines and trade covered. More specifically, one Participant inquired how Participants would view a SAT definition encompassing both 95 per cent of tariff lines and of trade.

13. Participants were generally in favour of further exploring the idea of ensuring that "highly traded" products were not excluded from the coverage of RTAs. The point was made that, in many instances, important products were not included in RTAs because of protectionist measures existing in one of the Parties. Therefore, the question of products with no or negligible trade, as raised in paragraph nine of the proposal, merited further discussion. Two suggestions were made as a way to deal with that, namely to also provide for requirements in terms of either a percentage of intra-trade exports *vis-à-vis* exports to all markets of the product in question or a percentage of aggregate trade covered. It was however noted that while in some cases the absence of trade was due to protectionist measures, in other cases this was due to genuine reasons; and this reality should be taken into account. Clarification was requested on (i) whether the idea would be to look at peak levels or three-year averages of "highly traded" products; (ii) the precise basis for the calculation of this percentage of trade between the parties, in particular whether it referred to trade volume or value, and to MFN trade; (iii) the reference period for each subsequent review; (iv) how to deal with yearly fluctuation of trade *vis-à-vis* the pre-defined list of "highly traded" products; (v) the precise requirements for "highly

traded" products, namely whether the sector should simply be included in the RTA or whether total liberalization – being it up-front or through a transition period – was required; (vi) whether these products would also be defined at the six-digit level; and (vii) whether the fact of providing for regular reviews meant that an RTA which had met all criteria at the first examination could be found not to be in accordance with WTO rules at a later stage.

14. One Participant noted that the submission only proposed a partial definition for SAT, given that it did not deal with other directly or indirectly related issues. He noted that the concept of "other restrictive regulations of commerce" (ORRCs) and its exemption list were directly linked to SAT, and requested the proponent to clarify whether ORRCs applied under Articles VI and XIX of the GATT 1994 – i.e. anti-dumping, countervailing duties and safeguards – should also be addressed as part of the SAT clarification. The balance that existed in Article XXIV:8 should be maintained; therefore, a clarification of SAT should also encompass the extent to which such trade remedy measures could be applied in an RTA. He noted his delegation's interpretation according to which trade remedy measures could not be applied to trade covered by free trade agreements or customs unions.

15. Highlighting the existing links between SAT and preferential rules of origin (PROOs) , some Participants advocated the need for further considering PROOs in the context of SAT discussions. The point was made that PROOs limited by definition the products covered under an RTA; over-burdensome PROOs could undermine the SAT requirement and limit actual trade volumes. The need for a clarification of the link between SAT requirements and "originating" products was referred to, in particular whether SAT should be defined only on the basis of "originating" products qualifying under the PROOs of an RTA. Finally, divergent views were expressed on the extent to which the SAT requirement applied both to originating products and other goods, including those transhipped or re-exported.

16. Divergent views were expressed on the appropriateness of assessing whether the SAT requirements had been achieved within ten years from the entry into force of the RTA. On one hand, it was noted that this was in line with reality; in general, RTAs prescribed a timeframe for the elimination of duties and could therefore be regarded, even if not explicitly recognized, as "interim agreements" which contained a plan and schedule for formation of a RTA as envisaged under GATT Article XXIV:5(c). On the other hand, some Participants noted that earlier liberalization of SAT should be the objective of any RTA. One Participant noted that ten years should be seen as the outer limit for phasing in liberalization commitments, and not as the normal standard. Some Participants rejected that statement on the grounds that in some instances, a longer transition period was needed so as to ensure that sensitive sectors were included in the agreement. One Participant highlighted the importance of having a review at the end of the phase-in period and of ensuring transparency, both throughout that period – by requiring the notification of changes made to the RTA – and thereafter, by providing for periodic reporting requirements.

17. While some Participants concurred with the proposed benchmark at entry into force, others reacted negatively to it. For one Participant any RTA providing for initial coverage below the proposed 70 per cent benchmark would be meaningless, while another Participant cautioned against the risk that flexibility could result in no trade being covered at the entry into force of an RTA. For other Participants, the proposed initial benchmark was not appropriate; rather, they favoured maintaining the flexibility currently provided under GATT Article XXIV regarding tariff elimination over a fixed period of time so as to suit their economic and domestic imperatives. In that context, the point was made that any test for initial liberalization should serve two purposes, namely to create an incentive for quicker liberalization and to provide flexibility for RTAs to have different starting points towards the ultimate goal of trade liberalization; therefore, a single benchmark for initial liberalization would not seem appropriate and would not capture the numerous ways in which RTAs provided for trade liberalization. Some alternatives to this unique benchmark were proposed, namely to simply eliminate any defined requirement regarding entry into force; to reduce it to 50 per cent; to

reduce duties on products by 70 per cent; to base the test on liberalization of existing trade or trade value; or, in particular in cases of RTAs between developed and developing countries, to allow for different levels of initial liberalization so as to arrive, within a defined timeframe, at a fixed benchmark.

18. Participants noted that the development dimension of RTAs merited discussion and analysis as RTAs could play a significant role in developing countries' economic development and integration into world trade. Participants agreed with the need for discussing special and differential (S&D) treatment for developing countries, and questioned whether the proponent had ideas on how best to reflect S&D in the SAT proposal. In particular, they were interested in discussing whether S&D should involve the application of different thresholds for RTAs between developing countries, and how to assess SAT in RTAs involving both developed and developing countries. In that respect, one Participant was of the view that the initial 70 per cent benchmark should be valid throughout the duration of developing countries' agreements. Another Participant noted that the Group had not yet reached an agreement on whether RTAs notified under the Enabling Clause would be subject to an improved review process. Another Participant noted that the proposed benchmarks, and the ten years time frame for phasing in commitments, would be difficult to implement for a number of developing countries, in particular in the context of negotiations for the conclusion of RTAs with developed countries.

19. Participants also addressed the question of application of any new or clarified rules to existing RTAs. The point was made that if this was required *vis-à-vis* the SAT definition, a number of RTAs might have to be re-opened; that would pose a problem in particular if not all of the RTA's parties were Members of the WTO. One Participant noted that while a general grandfathering of existing RTAs would not be in line with the overall purpose of the negotiations, this question should be addressed in light of, and in parallel with, discussions for the clarification of specific rules. One Participant reacted to that by proposing that this question be dealt with only once the Group had agreed on a SAT definition. The point was made that SAT discussions could be limited to future RTAs; for most of the RTAs in force, a review clause existed and any new interpretation could be dealt with in that context. Clarification was sought on whether the phased-in commitment would also apply to RTAs already in force.

20. Referring to the importance of clarifying the GATS concept of "substantial sectoral coverage" in a manner that would require the inclusion of the economically most important service sectors, with the exception of services being supplied in the exercise of governmental authority and secure a broad and real free trade within a reasonable timeframe, one Participant inquired whether the proponent intended to make a similar proposal on that GATS concept.

21. The proponent thanked Participants for the in-depth comments made, especially in light of the short time elapsed since the distribution of the proposal. Regarding the scope of the proposal, he noted that it related only to goods and to the elimination of duties under the SAT requirement; it did not include services nor RTAs notified under the Enabling Clause, nor did it dealt with the CRTA's role. While ORRCs were referred to in the same paragraph as SAT, there was no logical need nor reason for addressing the former, and the Group could therefore progress on the clarification of SAT with respect to duties only. Regarding the proposal's ambition, his delegation stood by the end-point benchmark of 95 per cent coverage; the initial 70 per cent benchmark was fairly generous; however, given that consistency with the end-point benchmark was the most important aspect, his delegation would be open to reconsider the initial benchmark. As regards technical issues, he clarified that a six-digit tariff line would be counted as having been liberalized only if all duties for the products underneath it were liberalized; partial liberalization would therefore be disregarded, and the same would occur if tariff-rate quotas remained. Given that the HS six-digit level was the only common standard among WTO Members, it represented the only workable basis for setting a numerical SAT definition. Regarding "highly traded" products, the two per cent referred to the value of imports, in

HS six-digit level, relative to the overall value of imports of one party from the other RTA party; average values would be used, rather than peaks; yearly fluctuation of trade would not be taken into account; rather, a snapshot would be made at the entry into force of the agreement, when these products would be identified. Referring to comments made according to which the proposal was over-weighted in terms of tariff lines and under-weighted in terms of trade coverage, he highlighted the importance of providing for high tariff-line coverage; it was his delegation's view that the trade approach was problematic in cases where trade was concentrated in a few tariff lines. While his delegation would be ready to consider an approach that would use tests on the basis of both trade and tariff lines covered, high standards would have to be set, and the proposal for a double 95 per cent benchmark appeared appropriate. Regarding products on which there was little trade due to high protectionist measures, the proposal simply noted the need to focus on greater transparency and analysis of overall export trade; however, his delegation remained open to further discussing any appropriate disciplines if Members felt it necessary. With respect to S&D, his delegation was of the view that the Group should pursue its work on defining SAT while also focusing on appropriate S&D, in particular *vis-à-vis* North-South RTAs. He reaffirmed his delegation's view that the definition should apply to all existing RTAs; while that might pose problems for some of them, most RTAs had review clauses which would allow for a re-adjustment of the RTA's coverage. Regarding the ten-year transition period, the proposal was that 95 per cent of tariff lines be covered by that time; however, other sensitive products could be liberalized on the basis of a longer transition period. Clarification was provided on the fact that the tests and benchmarks referred to "originating products" as per the RTA's PROOs, and that no obligation would apply to non-traded products due to genuine reasons; that could be worked out at the drafting stage. Regarding the CRTA's role, nothing in the proposal reflected a different view than that mentioned earlier by a Participant, namely that the CRTA should no longer be required to determine an RTA's consistency with the WTO rules. Regarding RTAs involving non-WTO Members, it was noted that this issue had been dealt with provisionally in the CRTA, but the Group might need to revert back to it at a later stage.

22. The Chairman thanked the proponent for allowing the Group to revive the systemic debate, in particular on a very substantive issue, and Participants for having engaged in a constructive discussion on the basis of detailed and in-depth comments, though of a preliminary nature. The submission would be further considered at the Group's next meeting. He invited other Participants to contribute to the Group's progress on the systemic debate, through the submission of proposals.

23. The Group held an informal debate on the basis of an informal note by the Chairman - entitled *RTAs Transparency Process: Subsequent Notification and Reporting*, dated 25 February 2005 - and two informal notes by the Secretariat - *Provision of Data on RTAs (goods)*, dated 24 February 2005, and the services "mock" presentation of the Canada-Chile Free Trade Agreement, dated 21 February 2005. At the end of the informal discussions, the Group reverted back to formal mode.

C. OTHER BUSINESS

24. The Chairman informed the Group that its next meeting would take place on 17-18 May 2005.