WORLD TRADE ORGANIZATION

TN/RL/W/179
12 May 2005

(05-1936)

Negotiating Group on Rules Original: English

SUBMISSION ON REGIONAL TRADE AGREEMENTS BY THE EUROPEAN COMMUNITIES

Paper by the European Communities

The following submission, dated 10 May 2005, is being circulated at the request of the Delegation of the European Communities.

SECOND SUBMISSION ON REGIONAL TRADE AGREEMENTS
BY THE EUROPEAN COMMUNITIES

1. This second submission of the European Communities sets out proposals on some of the core substantive provisions under GATT Article XXIV. The proposals build on the EC's previous submission (TN/RL/W/14) on the overall approach to, and scope of, the DDA mandate. The present submission is limited to some core systemic issues under GATT Article XXIV and is without prejudice to the position of the European Communities on future transparency requirements for all RTAs, as well as other substantive disciplines under GATT Article XXIV, GATS Article V and the relevant provisions of the Enabling Clause, that should be considered part and parcel of the negotiations.

1. The Overall Approach To Systemic Issues And Next Steps

2. The European Communities welcome the renewed engagement by the Negotiating Group on the "systemic issues" which Members have agreed to negotiate within the DDA. Encouraging steps have already been taken on technical elements of any future transparency requirements. Similar progress will now have to be made on the systemic issues. In doing so, Members should recall that the substantive WTO rules for regional trade agreements (RTAs) are meant to ensure that regional agreements support the open, rules-based multilateral trading system as well as further its objective of promoting growth in international trade and integration of developing countries into the world economy. However, the lack of clear and authoritative guidance on how to apply the relevant WTO rules has cast doubts on whether these rules indeed do fulfil their intended purpose. Furthermore, there has been a global proliferation of regional agreements, sometimes of poor quality, in recent years. This development has accentuated the potential challenges to the multilateral trading system arising from regional trade agreements.

3. The present situation is to the advantage of no one. While RTAs have become an indispensable trade policy tool for most WTO Members' pursuit of their economic and developmental objectives, all Members face the risk that the agreements to which they are not parties could have negative implications for their own legitimate trade interests. It should be in the interest of the entire Membership to clarify the existing WTO rules in the Negotiating Group as a contribution to progress in the DDA more broadly. Fundamentally, ensuring the proper functioning and good health of the open, rules-based multilateral trading system is something from which all Members stand to gain but

where also all Members will have to contribute if the clarifications of the rules are to make a difference in the future.

4. At the same time, in order to make progress, any future clarifications of the WTO rules for RTAs must be reasonable. The starting point for the clarification of WTO rules for RTAs can neither be the *a priori* exclusion of certain subsets of RTAs, nor the lowest common denominator of Members' past practices. This is increasingly urgent, since the recent surge in RTAs has not only made clarification of the WTO rules more pertinent, it may also have made clarifications more difficult to achieve in practice. At the same time, the negotiations must be based on the recognition that Members have interpreted the relevant WTO rules differently and, hence, adopted different approaches in their RTAs. Any future clarifications would have to take into account such variations in approaches by Members, while going beyond the lowest common denominator.

5. The developmental dimension of regional trade agreements must also constitute an integral part of the clarification and improvement of WTO rules for RTAs. Regional integration can play an important role in promoting economic development in so far the agreements are sufficiently ambitious and take into account the specific needs and constraints of developing and least developed countries. The negotiation should include, *inter alia*, consideration of clarifications of WTO rules on RTAs that supports the developmental impacts of RTAs as well as recognition that the potential challenges arising from such RTAs to third parties' trade and to the WTO at large may be very different depending on the share of world trade and the level of development of the parties to RTAs.

6. In light of the debate on the systemic issues, the European Communities believe that the application of these three overriding principles - shared systemic interest, reasonableness and the developmental dimension - will be instrumental for meaningful progress in the negotiations to clarify and improve WTO rules for RTAs within the DDA. This submission by the European Communities builds on the suggested approach. It limits itself to identify some core elements, aimed to be broadly acceptable to all WTO Members, for future clarification of issues related to the so-called coverage and neutrality of RTAs in goods that fall under GATT Article XXIV.

2. Coverage: "Substantially All The Trade"

7. The requirement of GATT Article XXIV, paragraph 8, to eliminate "duties and other restrictive regulations of commerce … with respect to substantially all the trade" between RTA parties, is one of the key systemic issues for negotiation. However, so far, discussions in the Uruguay Round and subsequently in the Committee on Regional Trade Agreements (CRTA) on how to clarify this requirement and to establish quantitative and qualitative benchmarks have been inconclusive.

8. Members' positions have remained divergent on the issue of appropriate levels and types of quantitative benchmarks. Concerning the possible types of quantitative benchmarks, as described in a report by the Secretariat (WT/REG/W/46, p. 5) from 2002, "[t]he percentage of trade method has been traditionally favoured as an indication of RTA coverage in the GATT/WTO context." Judging from many, if not most, Members' interventions on this issue in recent meetings of the Negotiating Group, this appears still to be the case. The European Communities share the view that any numeric benchmark for coverage would have to be based first and foremost on the coverage of trade. At the same time, the European Communities are ready to explore with other WTO Members the possibility, and practical implications, of supplementing a benchmark based on coverage by trade with an assessment of trade coverage measured by number of tariff lines. For example, one compromise option worth further consideration would be to establish a combined average threshold for trade and tariff lines. A combined average threshold would ensure that RTAs cover existing as well as potential future bilateral trade between parties, while partly accommodating the traditional differences in Members' emphasis on the two forms of possible benchmarks.

9. Concerning the appropriate level of quantitative benchmarks, this issue obviously cannot be determined now, but will have to be negotiated once some convergence has been achieved among Members on the possible types of benchmarks to be used and the methodology for calculating them. What is important for the European Communities, as well as probably for most Members, is that the level of the numerical threshold needs to reflect a reasonable balance between the shared systemic interest in clarifying the rules and Members' interpretation of the disciplines to date.

10. Moreover, the European Communities are of the opinion that any future quantitative benchmarks can only serve as a tool for assessment and a guide to *likely* WTO-conformity. The concept of "substantially all the trade" also pertains to quality of internal elimination of duties and other restrictive regulations of trade between RTA parties. In order to facilitate the determination of compliance with GATT Article XXIV, Members must therefore endeavour to reach common understanding on key qualitative benchmarks for RTAs. This would include, *inter alia*, more precise definitions of the concepts "major sector" and "other restrictive regulations of commerce"; clarification of nature of the list of exceptions from the obligation to eliminate duties and other restrictive regulations of commerce in Article XXIV:8 (a)(i) and (b); assessment of the impact of possible seasonal restrictions, special sectoral safeguards and tariff-rate quotas; and taking into account review clauses and in-built provision for extension of the coverage of RTAs within established transition periods. However, while common understandings on some of these aspects would be advisable, any qualitative assessment of RTAs would by necessity have to be made on a case by case basis. Therefore, when a given RTA meets a future quantitative benchmark, this would constitute an element of greater security as to whether the agreements conforms to GATT Article XXIV, but would not constitute an automatic guarantee of conformity, as the other elements above will also have to be weighted.

3. Transition Periods: "Reasonable Length Of Time" And "Exceptional Cases"

11. GATT Article XXIV, paragraph 5 (c) requires that interim agreements leading to the creation of a Customs Union or Free Trade Area should include a plan and schedule for this process, which should be completed within a "reasonable length of time". In the Uruguay Round, Members clarified that this requirement "should exceed 10 years only in exceptional cases". The Secretariat report of 2002 (WT/REG/W/46, p.18) revealed that, for many of the RTAs entering into force in the latter half of the 1990s, "only in rare cases do transition periods exceed ten years". In the recent surge of RTAs, however, transition periods have been known to go well beyond ten years. These cases are becoming the rule rather than the exception.

12. In part, the present situation is probably due to the lack of authoritative guidance of the concept of "exceptional cases". The European Communities continues to consider that, if at all invoked, "exceptional cases" should only be applied to a limited number of products under RTAs, should not unreasonably postpone the end of the transition periods, and should be used only for prolonged phase-in of commitments by developing and especially least-developed countries, not by developed countries. At the same time, it could also be recognized that some other Members have adopted longer transition periods in a limited number of RTAs where the parties have agreed to go well beyond the requirement of "substantially all the trade" coverage. The European Communities are open to consider clarifications of the limited circumstances where such departures from the rule of ten years may be justified.

4. Neutrality: "Other Regulations Of Commerce"

13. GATT Article XXIV, paragraph 5, sets out the requirements which a Customs Union or Free Trade Area must meet in respect of its impact on the interest of non-parties. While the obligations with respect to duties have in part been clarified already, there is no generally agreed definition of what constitutes "other regulations of commerce" for the purposes of this Article, nor of the

methodology to be followed in determining whether such other regulations have become more restrictive as a result of the formation of a Customs Union or Free Trade Area.

14. For obvious reasons, the concept of other regulations of commerce appears to be broader than the concept of "other restrictive regulations of commerce" in Article XXIV:8. The European Communities are open to clarifying and expanding the scope of "other regulations of commerce", including the possibility that preferential rules of origin would fall under the concept, but only in so far that any future definition would be sensible, practical and not give rise to perverse outcomes with regard to the existing neutrality test. The suggestion by Korea (TN/RL/W/116) to use the Standard Format list to help clarifying the scope of the concept may serve as a starting point. However, it should be noted, as Korea already pointed out in its submission, that this list is very comprehensive. It may not provide the precision needed to establish a practical definition of the concept that, in turn, can be used to determine neutrality. In addition, using a broad definition of the concept would make it very difficult to approach all tentative "regulations of commerce" in the same manner when determining their impact on third parties. The wider the definition, the more it covers regulations which are only remotely related to trade, or areas where WTO Agreements already establish certain rights and obligations for Members.

15. Therefore, there is a need for different approaches to neutrality for different forms of "regulations of commerce". In particular, the European Communities consider that those regulations falling under existing WTO Agreements cannot be questioned on grounds of neutrality, if the parties of the RTAs fulfil their rights and obligations under those Agreements. Moreover, any assessment of neutrality will inevitably have to be made on a case by case basis, where also the long term positive effects for third parties from harmonisation and deeper integration under RTAs will have to be fully acknowledged.

5. Developmental Aspects: Fair And Equitable Treatment Between Different Forms Of RTAs To Which Developing Countries Are Parties

16. In line with what was implied in the submission by the ACP (TN/RL/W/155, p.2), the European Communities consider that better coherence must be ensured between developmental dimensions in the different WTO rules for RTAs. At present, there seems to be little coherence, let alone logic, to the treatment of the various types of RTAs to which developing countries are parties. The WTO disciplines for RTAs are arguably deficient in at least two ways:

(a) Existing rules fail to create fair and equitable treatment between different types of RTAs based on their developmental impacts and promotion of developing countries' participation in world trade. For example, while preferential tariff and partial liberalization agreements among developing countries fall under the Enabling Clause, ambitious and full-fledged RTAs, such as Free Trade Agreements between developed and developing countries, are subject to the stricter requirements of GATT Article XXIV. Yet, North-South RTAs can have at least as high a developmental impact as any of those falling under the Enabling Clause, and it is difficult to see why the substantive requirements should be radically different.

(b) Existing rules fail to establish fair and equitable treatment between different types of RTAs based on their potential effects on third parties. For example, no distinction is made in respect of regional trade agreements among developing countries that are relatively sizeable actors in world trade, and whose RTAs therefore are likely to have implications on other WTO Members and for the system as a whole, as compared to those between parties who represent only a small portion of world trade. The disparity appears especially obvious if one compares an RTA between developing countries who would be major traders (and which would fall under the Enabling

Clause) with some existing RTAs among relatively small trading nations who are subject to the more comprehensive disciplines of GATT Article XXIV.

17. Improvements and clarifications to the existing WTO rules for RTAs should aim to ease such problems of coherence. Firstly, in the negotiations, specific consideration needs to be given to the tangible benefits of deeper economic integration through more ambitious regional trade agreements among developing countries (just as through agreements between developed and developing countries).

18. Secondly, it should also be recognized that the ability of many developing countries to adjust to greater competition on their domestic markets, or to take full advantage of additional market access opportunities under RTAs, may depend on their own individual level of development, particularly in RTAs with developed countries. Therefore, the European Communities believe that the DDA negotiations on RTAs should aim to clarify the flexibilities already provided within the existing WTO rules on RTAs, in order to give greater security to developing country parties to RTAs to ensure that the rules facilitate the necessary adjustments. The European Communities are prepared to explore various ways of achieving this aim, including the extent to which flexibilities might be appropriate with respect to, *inter alia*, the length of the transitional period, the level of final coverage and the degree of asymmetry for both under GATT Article XXIV. More specifically, the European Communities are open to consider separate and differentiated, i.e. lower, thresholds for developing countries and least developed countries, as proposed in the submission by the ACP-countries (TN/RL/W/155). Moreover, longer transition periods might be necessary to facilitate market building and consolidation through gradual openness to trade in weak and vulnerable developing countries, taking into account their specific needs and constraints. The European Communities would thus like to confirm in the negotiations these specific justifications for developing country parties to RTAs to depart, where necessary, from the general rule of ten years maximum.