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SUBMISSION ON REGIONAL TRADE AGREEMENTS

Paper by Japan

The following submission, dated 28 October 2005, is being circulated at the request of the Delegation of Japan.

I. INTRODUCTION

In this submission, Japan has put forward the following proposals as our contribution to the efforts in this Group of Negotiations to clarify the WTO rules for RTAs. The proposals are based upon the following understandings:

- (1) As regards RTAs' consistency with WTO rules, many members have been involved in RTA negotiations under the general perception that duty elimination needs to cover at least 90% of trade between the parties, that no exclusion of a major sector is allowed and that the transition period should not exceed ten years.
- (2) This Group has developed discussions and has reached the recognition that a trade-based coverage benchmark, which Japan favors, has both advantages and disadvantages and that the disadvantages need to be supplemented by some other measures.
- (3) In our examination of RTAs, a comprehensive approach needs to be taken evaluating not only the quantitative aspect but also the qualitative aspect.

Japan reserves our right to submit additional proposals depending on the subsequent progress to be made in the discussion, and is open to further discussion on any issue indicated in this paper.

II. BASIC PRINCIPLES ON QUANTITATIVE BENCHMARK

In interpreting the requirements of "Substantially All the Trade", the quantitative benchmark has crucial importance and in defining or applying new rules governing RTAs, there are several elements we should bear in mind as basic principles.

- (1) The quantitative benchmark should be defined in such a way as to effectively avoid exclusion of products with a large trade flow. The benchmark should be as simple as possible. The specific figure as a threshold of the benchmark should be discussed at

later stage when more convergence is achieved in many related issues. Japan would like to make a contribution at that stage of the discussion.

- (2) The RTA's consistency with the benchmark should be examined based on the duty elimination agreed to be completed within the transition period.
- (3) An adequate transition period should not exceed ten years, but it should be further discussed in what exceptional cases a longer period may be admitted, and whether a positive evaluation could be given for duty elimination beyond the transition period in the context of the qualitative benchmark.

III. COMPARISON OF COVERAGE TEST BETWEEN TRADE BASE AND TARIFF LINE BASE

1. Distinctive differences between the two tests

Between the two types of quantitative benchmarks on coverage, a tariff line-based test¹ does not reflect the trade volume of products, although it is irrespective of trade fluctuation, and consequently can score a high coverage rate even when it allows a higher exclusion of products with a large trade volume. This concern tends to be more conspicuous when trade among RTA parties concentrates only limited number of products.

On the other hand, a trade-based test does not cover products with no trade, although it reflects an actual pattern of trade, and as a result it is likely to allow a higher exclusion in products with no trade.

2. Which test is preferable and more ambitious?

In the case of products with a large trade volume, duty elimination would lower the price of imported products by the extent of the previous tariff level, and would usually expand the volume of those imports.

As for the products with no trade, reasons why there is no trade varies, from the restrictive effects of high tariffs, to the market conditions such as the lower price of domestic products, a lack of extra-supply in the exporting country and an absence of demand in the importing country. Therefore, duty elimination in products with no trade would not always lead to the expansion of imports. In terms of its effect on trade expansion, it is Japan's view that a trade-based test would be our preferred option.

In the discussion of this Group some Members contended that a tariff line-based test is more ambitious, but we wonder if it is true. Under a tariff line-based test, parties can raise the coverage rate to fulfil the benchmark by merely eliminating duty in products with no trade. Therefore, if only a tariff line-based test is applied, the duty elimination of products with a large trade volume would be less encouraged than in the case when a trade-based test is applied. Given the effects of these two tests, the tariff line-based test is not always more ambitious than the trade-based test.

¹ Members have proposed various types of tariff line-based tests. In general, those tests require elimination of duties on most products, for instance, at least 95 percent of tariff lines at six-digit level of Harmonized System.

3. Which test should be adopted for the coverage benchmark?

Considering these elements, Japan, who puts priority on the trade expansion and less exclusion of products with a large trade volume, prefers a trade-based test as the primary methodology of the coverage benchmark. This position is reinforced by the fact that a trade-based test has been traditionally favored by many countries and has the advantage of being able to show a good reflection of the actual trade flow.

IV. SUPPLEMENTS TO THE TRADE-BASED TEST

In adopting the coverage benchmark on a trade basis, the following are the possible difficulties we need to address:

- (1) The coverage rate is subject to the fluctuation of trade flow.
- (2) The coverage rate may be mismatched with a possible trade pattern in the future.
- (3) Duty elimination may be underestimated in products with no trade.

These difficulties will persist as far as the trade volume is used for a benchmark either for a coverage rate test or for some other supplementary test. Combining a trade-based test with a tariff line-based test for a coverage rate may be among the options we can explore to lessen the negative effects of these difficulties, but a mere simple combination may not provide us with a satisfactory solution.

In this sense, Japan proposes, as the coverage benchmark, a trade-based test accompanied by some supplementary measures designed to address the exact difficulties. The following are some examples of supplementary measures we may take in order to address the three problems mentioned above.

1. Coverage rate is subject to the fluctuation of trade flow

Although we share the concern that trade fluctuation may make the coverage figure too volatile to accurately examine the nature of RTAs, if we use the same trade data for our reviewing of RTAs as that used by contracting parties during RTA negotiations, the coverage rate can be independent from trade fluctuations for reviewing purposes. In other words, in the reviewing process we should use, for coverage calculation, the latest trade data available upon the completion of the agreement (i.e. upon the RTA's signature or its entry into force depending on the situation). In that case, trade data may be the average of three or more years rather than that of single year in order to mitigate the fluctuation of every year.

As for the subsequent fluctuation of trade, we can update the coverage rate accordingly, and if we conduct a periodic reviewing thereafter, we could continue an appropriate examination of RTAs and would be mostly relieved of the difficulty resulting from year by year trade fluctuation.

2. Coverage rate may be mismatched with a possible trade pattern in the future

Upon the completion of RTAs, it is hard to foresee a future trade pattern and the supply-demand situation, and a one time review on the coverage rate might possibly be outdated. However, the above-mentioned periodic reviewings would enable us to respond to the subsequent change in trade flow and again would provide us with a solution to this difficulty. A trade-based test can

especially serve as a good sensor to emerging trade flow, which would lower the coverage rate by increasing the denominator, if the trade is created in excluded products that still maintain a duty.

3. Duty elimination may be underestimated in products with no trade

In the case where high tariff precludes the possibility of future trade creation, a trade-based test will give parties no incentives to improve the situation since that test underestimates the duty elimination in a product with no trade. Another approach rather than just a periodic reviewing should be considered to address this concern. One possible solution is that we calculate the percentage number of products whose previously maintained WTO bound rate is eliminated with the RTA among the total number of products with no trade. This calculation will provide us with a more effective method to evaluate Member countries' efforts to eliminate duties than an ordinary coverage rate that counts products with zero duty by WTO bound base as well as those agreed in the RTA. This calculation can also induce parties to be prepared for any trade pattern in the future, responding to our concern mentioned in (2) above.

The tariff classification used for this calculation should be made at the HS 6 digit level, which is the internationally harmonized classification in order to avoid the discretionary reclassification of the tariff at 8 or 9 digit level, i.e. the HS 6 digit level plus a national subdivision, so as to increase the coverage.

V. ISSUES TO BE EXAMINED AS THE QUALITATIVE BENCHMARK

For a coverage benchmark to appropriately evaluate RTAs, it needs to take a comprehensive approach by taking account of the qualitative benchmark that will play a complementary role to the quantitative benchmark of the coverage rate. We should further discuss ways a qualitative assessment is used and linked, positively or negatively, with the coverage rate in our evaluation of "Substantially All the Trade".

The following are some of the issues Japan considers as relevant for qualitative examination, and this Group should further discuss how these should be evaluated and factored respectively in the coverage benchmark.

1. Tariff elimination with a longer transition period

It is also important to give due regard to products whose duties will be eliminated not within a transitional period. These types of products may be treated differently from those just excluded from duty elimination without any commitment.

2. Assessment of tariff quotas

When a tariff quota is introduced in products whose high tariffs limit their market access opportunity, its effect upon trade expansion may be the same as that of duty elimination in certain cases. Due consideration should be given to trade promotion effects of tariff quotas.

3. The extent of tariff reduction

The extent of trade expansion under an RTA significantly varies depending on whether the previously applied rate was high, low, or zero. It is questionable if these products should be treated in the same way without distinction.

4. Impact of RTAs upon Development

RTA's positive impacts on development in various economic activities for the parties of the RTA who are developing countries should be qualitatively assessed in some manner. Due consideration should be given to these developmental aspects in the application of the benchmark of RTAs.

5. Influence of measures of trade remedy

Fair assessment should be given to the application of safeguard measures or the abusive use of anti-dumping measures that have similar effects with the withdrawal of concessions to eliminate tariff.

6. Exclusion of a major sector

Total exclusion of a major sector should not be allowed in a RTA even if it fulfils the quantitative test of coverage. Further examination is necessary on how this issue should be fairly handled.
