WORLD TRADE ORGANIZATION

TN/RL/W/114
6 June 2003

(03-2958)

Negotiating Group on Rules

Original: English

DISCUSSION PAPER ON REGIONAL TRADING ARRANGEMENTS

Communication from India

The following communication, dated 6 June 2003, has been received from the Permanent Mission of India.

I. INTRODUCTION

1. The WTO's Annual Report for 2002 (WT/TPR/OV/8) has noted that the surge in RTAs has continued unabated since the early 1990s. Some 250 RTAs have been notified to the GATT/WTO upto June 2002, of which over 170 RTAs are currently in force. It is also indicated that by end of 2005, the total number of RTAs might well approach 300.

2. The multilateral framework for international trade under the WTO rule based system needs to be strengthened by addressing issues of concern emerging on account of formation of such a large number of RTAs including their impact on development. Though RTAs are an alternative window of trade liberalisation as well as an alternative framework of development between more limited sets of countries or economies, it is important that they complement multilateral trade liberalisation and not create complications for that goal or occur at the cost of trade or development of countries not members of particular RTAs. In this context, it is important to emphasise the basic principle of RTAs as enshrined in Article XXIV (4) of GATT 1994 that they are meant to facilitate trade between the constituent territories and not to raise barriers to the trade of other Members. Seen in this backdrop, it becomes important to examine the legal framework of RTAs in the light of the mandate of the Doha Ministerial Declaration. The present submission is limited to GATT Article XXIV**,** and the review mechanisms provided under the Committee on Regional Trade Agreements (CRTA).

3. Para 29 of the Doha Ministerial Declaration reads as follows: "We also agree to negotiations aimed at clarifying and improving disciplines and procedures under the existing WTO provisions applying to regional trade agreements. The negotiations shall take into account the developmental aspects of regional trade agreements." While discussions are already taking place in the Negotiating Group on Rules (NGR) on transparency issues, the underlying systemic issues have not been substantially visited, which will be the purpose of this submission.

4. Some areas of concern in the existing disciplines and procedures relating to RTAs and suggested means of addressing them are highlighted below. Several issues that arise today on account of deep integration of existing RTAs may require further clarification of GATT Article XXIV as this Article was originally developed essentially to take care of market access barriers at the border in line with the GATT framework. The 'developmental aspects' of RTAs is the underlying principle of the proposals suggested below.

II. SUBSTANTIALLY ALL THE TRADE

5. Formation of a RTA should be welfare enhancing for the participants. Meaningful welfare gains require closer integration between the economies of the participants i.e. the RTA extends to as large a proportion of the trade as possible. We have seen, however, that even RTAs between developed countries formed under GATT Article XXIV still leave out sectors like agriculture from integration. This limits trade creation and consequently the welfare gain to participants.

6. Keeping in view the above, Members may like to define "substantially all the trade" for purpose of GATT Article XXIV in terms of both (i) a threshold limit of the HS tariff lines at the six-digit level; and (ii) the trade flows at various stages of implementation of the RTA.

III. RTAS UNDER ENABLING CLAUSE

7. Certain proposals have been made to bring the RTAs signed under the Enabling Clause between developing countries within the ambit of GATT Article XXIV transparency mechanism, that is, to subject such agreements to review under the CRTA. This is an issue of great concern. It is important to emphasise that the 1979 Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries (more commonly known as the Enabling Clause) is a codification of the concept of "Differential and More Favourable Treatment" for developing countries as well as of the principle of non-reciprocity in trade negotiations. Paragraph 44 of the Doha Ministerial Declaration has reaffirmed that the provisions for special and differential treatment are an integral part of the WTO Agreements. In this light, any attempt to dilute the provisions of the Enabling Clause would be contrary to the spirit of the WTO framework as well as of the Doha Ministerial Declaration.

8. The character of the Enabling Clause should not be altered in any way as it is inextricably linked to the development needs of the developing countries. The development dimension of the Enabling Clause is that while developing countries seek greater economic integration with other countries, they also need to have enough policy space to be able to adjust to greater competition in the domestic markets or to calibrate their market liberalisation to their individual level of development. It also provides them flexibility in making structural adjustments, a mechanism to build public consensus for trade liberalisation led reforms and also a laboratory to learn the lessons of market opening without paying a prohibitive price in terms of social and economic upheavals, that may, at times, be paid when such an opening up is at the multilateral level.

9. The moot point is what is sought to be achieved by suggesting a change in the procedure for examination of RTAs under the Enabling Clause. Is it a precursor to applying more rigorous disciplines of GATT Article XXIV? Keeping in view the legal basis of the Enabling Clause as elaborated in Para 7, this would not be the mandate of the present negotiation. Notification and examination of Enabling Clause RTAs in the CRTA would cast enormous additional burden on developing countries, which would not be justified in view of the relatively small share of world trade covered under such RTAs. On account of these reasons, it is not advisable to change the notification requirement of RTAs under the Enabling Clause and the existing system of notifying such RTAs to the Committee on Trade and Development (CTD) should continue.

IV. TRANSPARENCY OF RTAS FORMED UNDER GATT ARTICLE XXIV

10. The substantial growth of RTAs formed under GATT Article XXIV and the inability of the CRTA to effectively examine them indicates an urgent need to clarify the principles concerning notification and examination of such RTAs. There is a need for a clarification regarding the time of notification. It would be appropriate to have a two-step process of notification of an RTA. An outline of the new Agreement could be notified to the WTO at the time of signature of the RTA, but prior to

its ratification, and a second notification could be made after a RTA's ratification, but before its entry into force. The second notification could be a full and detailed notification. Such a process would address the legal problems faced by those countries that cannot notify an RTA before its ratification by the parties to an Agreement. It would be important to ensure that the initial notification requirement should not be very burdensome and it could largely be based on the public announcements made. The first of the two-step notification could act as a kind of database and a monitoring mechanism for receiving a detailed notification later on. It would also be useful to define a time frame for notifying changes to an RTA. One guiding principle on this issue could be the existing provision in Article 5.1 of the Agreement on Import Licensing Procedures which sets a time frame of 60 days for notifying changes made in import licensing procedures.

11. Keeping in view the increasingly comprehensive and complex character of RTAs, it would be useful if WTO Members can be made familiar with the various provisions of an RTA at as early a stage as possible of its establishment and could also be presented with an analysis of its impact on the multilateral trading system. This can be achieved through a prior factual analysis of the RTA by the WTO Secretariat. Such an analytical report would help all Members to better understand the functioning of the concerned regional trading arrangement and thus enable them to participate more constructively in the examination exercise. The WTO Secretariat could compile such an analysis on the basis of information provided by RTA Members as well as information available in the public domain like research papers of reputed institutions. Given concerns of some Members regarding use of information available in public domain, it would be useful to further discuss the scope of materials to be used from public domain. In addition to the initial review, there could be a fixed periodicity of summary review of existing RTAs depending on the share of their trade on lines of the present Trade Policy Review Mechanism (TPRM). To avoid undue burden to the RTA members, there should be a sufficiently large time gap between two such reviews. To enable the WTO Secretariat to carry out such regular assessment of RTAs based on the share of the trade flows, there should be a requirement for RTA Members to submit data concerning trade. This could help in understanding at a broader level as to whether the RTA has served or is serving to create overall expansion of trade and fuller use of resources.

V. RTAS AND PREFERENTIAL RULES OF ORIGIN

12. A systemic issue is whether Preferential Rules of Origin (PRO) can be considered as "other regulations of commerce" (ORCs) under GATT Article XXIV:5. PROs under FTA, in a way, serve the same purpose as common tariff in the customs union, that is, to regulate the entry of goods in the RTA and in that sense they can be understood as a regulation of commerce.

13. It is recognised that a complete harmonisation of preferential rules of origin would neither be practicable nor desirable as such preferential rules of origin are often derived from production and trade structures in place between the RTA members and are designed to meet certain specific requirements as identified by the RTA parties. It is also understood that harmonisation of preferential rules of origin would require a re-negotiation of the WTO Agreement on Rules of Origin as presently preferential rules of origin are kept out of the ambit of the harmonisation exercise- even the experience of harmonising the non-preferential rules of origin under the ARO has been highly disappointing till date.

14. Nevertheless, some of the existing provisions of preferential rules of origin have significant trade diversionary effect or create barriers to trade of non-RTA Members. One such identified element is the requirement in some PROs that the raw materials used for the next stage product conversion taking place in a RTA Member country should be sourced from one of the RTA Member countries. For instance, there is a requirement in the PRO of a major RTA that for a large category of fabrics, made-up articles and apparels to get the benefit of preferential tariff under that RTA, these should contain yarn or fibre made in a RTA Member country. The implication is that a third country which

has an export market, of say fabrics, to one of this RTA Member country would be required to use yarn sourced from a RTA Member country, as otherwise, the processor of the fabric (into made-ups or apparels) located in the RTA Member country would not be able to avail the preferential tariff benefit for its manufactured goods (made-ups or apparels) when exported to another Member of this RTA.

15. The effect of such rules for non-RTA Members is very harmful, particularly for such countries, which enjoy a traditional market access for fabrics in such countries. Certain countries might be located far away from the RTA Member countries and would thus incur much higher cost for importing raw materials like yarn, from a RTA member country, and then processing and exporting the final product to the same RTA Member country. As a result, the final product of the non- RTA Member becomes un-competitive vis-à-vis the production carried out in RTA Member countries. This also causes investment diversion as, to avoid the problems of meeting such complex rule of origin, manufacturers would set up manufacturing bases for intermediate raw materials within or near the RTA Member countries.

16. Another complex origin rule identified in a RTA is that for clothing and coats to be entitled to the benefit of preferential tariff, linings should originate from the fabric stage from one of the RTA Member countries. Such rules appear to go far beyond the requirement of substantial transformation envisaged under value addition criteria. Such requirements, in fact, would also appear to attract the provision of TRIMS as it, in effect, imposes a 100% local content requirement for some inputs. It would be useful for Members to identify and compile such anomalous and trade restrictive PROs.

17. It is suggested that the value addition norms of PROs for RTAs between developed countries should not be less stringent than the value addition norm provided under GSP scheme operated by any of the developed country, which is a member of the FTA. This would ensure similar market access conditions for goods of GSP beneficiary developing countries vis-à-vis goods of developed country RTA members.

18. Another area of concern in existing PROs is the prevalence of a system of diagonal cumulation between various RTAs or for some countries vis-à-vis an RTA without any formal agreement as understood under GATT Article XXIV. Such methods of better market access to some countries that are not Members of an RTA to the exclusion of other countries do not appear to be in conformity with Article XXIV:4 and XXIV:5 of GATT 1994.

19. In view of this, it would be useful to arrive at an understanding that rules of origin are other regulations of commerce and that they should meet the criteria set forth in GATT Article XXIV:4 and XXIV:5, namely, that they shall not raise barriers to trade of non-Members of RTAs. Certain tests can be set to meet this criteria like tests of proportionality, least-trade restrictiveness and non-violation of fundamental provisions of GATT, including GATT Article III:4. Some specific criteria would be included to meet these tests like: (a) there should be no requirement that the raw material used for next stage product conversions should be 100% originating in a RTA Member country; (b) there should be no insistence for use of particular originating items to give origin to a product (like fabrics for apparel, lining for coat); value addition norms of PROs for RTAs between developed countries should not be less stringent than the value addition norms provided under GSPs provided by developed country RTA Member; system of diagonal cumulation would not be adopted by RTA Members.

20. As PROs are very important aspect of RTAs, its examination should be given a prominent place in the scheme of examination of RTAs.

VI. RTAS AND REGULATIONS RELATING TO SANITARY AND PHYTOSANITARY MEASURES (SPS) AND TECHNICAL BARRIER TO TRADE INCLUDING STANDARDS (TBT)

21. The GATT Article XXIV:4 recognises that the purpose of a customs union or of a free trade area is to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories. However, putting the provisions for harmonisation of rules of recognition for SPS/TBT measures between the RTA Members on a fast track procedure or a simplified procedure, acts as barriers to exports for non-RTA Members. Such fast track procedures are not followed for the non-RTA members and, therefore, their goods are denied market access till such time as the normal and time taking procedure for non-members are complied with. The additional time and costs involved for the non-RTA members is a market access barrier because such factors add to the cost of the exported product.

22. RTAs often involve mutual recognition of each other's certification agencies, standardizing bodies and in some cases mutual recognition of standards (MRA). It is recognised that this facilitates trade amongst the RTA Members. However, it would be desirable to extend similar opportunity for mutual recognition of standards, conformity assessment systems, certification bodies to non-RTA Members if they request for similar arrangements. There appears no justification to deny such recognition opportunity on MFN basis to the non-RTA members. Provision of such an opportunity on MFN basis could be facilitated by arriving at an understanding that the norms and procedures under which the standardizing bodies and certification agencies are mutually recognized between RTA Members would be notified to CRTA or CTD as the case may be. A further understanding could be reached that the RTA members shall afford adequate opportunity for other interested Members to negotiate their accession to such an MRA or arrangement or to negotiate comparable ones with them within similar time frame and similar simplified procedures as existing for the RTA members. Such a provision could be formulated in line with the language as in Para 2 to 5 of GATS Article VII.

23. There does not appear any legal basis for permitting any derogation for MRAs between RTA Members. In an article by Joel P. Trachtman presented during the WTO Seminar on 'Regionalism and WTO' during April 2002[1] it has been argued that it would be difficult to justify maintenance of such mutual recognition agreement under GATT Article XXIV:8 on the ground that this is required in view of the requirement of elimination of "other restrictive regulations of commerce" (ORRC) for formation of a customs union or a free trade area. It can be argued that TBT/SPS measures are not ordinarily "restrictive" or "regulations of commerce" because they are not intended, as duties are, to reduce market access. If we regard all TBT/SPS measures as ORRC, it would lead to a rather untenable conclusion that Article XXIV:8 (a) (i) and Article XXIV:8 (b) would require elimination of SPS and TBT measures. A more rational inference would, therefore, be that only a sub-category of TBT/SPS measures can be regarded as ORRCs; namely those that are either discriminatory or unnecessary. Hence, it cannot be argued that harmonisation of standards or conformity assessment procedures *per se* are a pre-condition for formation of RTAs and hence, a permitted derogation.

VII. RTAS AND TRADE DEFENCE MEASURES

24. The primacy of the WTO rules in the area of trade defence measures, namely, for anti-dumping, countervailing and safeguard measures should be maintained. In particular, it is important to highlight the MFN character of the safeguard duties as provided for in Article 2 of the WTO Agreement on Safeguards. The provisions of GATT Article XXIV do not appear to permit any

[1] Toward Open Recognition? Standardization and Regional Integration under Article XXIV of GATT: Prepared for WTO Seminar on The Changing Architecture of the Global Trading System: Regionalism and the WTO: Joel P. Trachtman April 22, 2002

derogation from the principle of MFN treatment for safeguard measures. It would be useful to affirm this principle in the results of the present negotiation so that there is no scope of adopting a differing interpretation on this issue and thereby keep members of an FTA or a Customs Union out of the purview of a safeguard action if it is initiated by one of the members of the FTA or the Customs Union. Another issue that could be addressed is derogation from the standards of safeguard investigation for taking action only against RTA Members. One way to address this issue could be to arrive at an understanding that such a derogation could be permitted when tariffs are increased from preferential level upto the MFN level, that is, preferences were suspended between regional parties, while the disciplines of the WTO Agreement on Safeguard would apply for raising duty above the MFN level.

25. Similarly, it would be useful to arrive at an understanding that in the application of regulations governing imposition of anti-dumping or countervailing duties between the RTA members, the parameters set for injury determination, or the time frame set for imposition of duties would not be different from that provided for in the relevant WTO Agreements. This would help to have harmonised WTO and RTA rules in the area of trade defence measures and would thus strengthen the multilateral rules in this important area.

VIII. GRAND FATHERING OF EXISTING RTAS

26. During the negotiation some countries have suggested to grand father the existing RTAs and to apply the results of the negotiation under the Doha mandate from a future date. This is a matter of concern. Given the fact that the maximum proliferation of RTAs has taken place during 1990s and that this trend continues unabated during this decade, it would be extremely important to analyse the impact of such RTAs on the multilateral trading system by applying the results of the negotiation on improvement and clarification of provisions of RTAs which hopefully would include improved transparency clauses. If the results of negotiation are not applied to the existing RTAs, it would lead to an abnormal situation where the fruits of the efforts of negotiation would only be available for the future RTAs whereas the Members' proposal for clarification of GATT Article XXIV is based on their experiences with the existing RTAs. It is, therefore, felt that the suggestion of grand fathering the existing RTAs is in general not a correct proposition keeping in view the overall purpose of these negotiations.