

Committee on Regional Trade Agreements

SYNOPSIS OF "SYSTEMIC" ISSUES RELATED TO REGIONAL TRADE AGREEMENTS

Note by the Secretariat

The purpose of this note is to provide the Committee on Regional Trade Agreements (CRTA) with a structured synopsis of issues that have been identified as having a systemic significance in the course of CRTA discussions to date.

Although "systemic" issues have mainly been discussed under item 1(d) of the Committee's Terms of Reference, certain issues of a systemic nature have also been raised under other items of the terms of reference (for example in the examination of individual agreements). The Secretariat has attempted to make a comprehensive review of all "systemic" issues. Reference has also been made to relevant findings in panel and Appellate Body reports.

Although it is difficult to provide a watertight classification of "systemic" issues raised in the CRTA, the Secretariat has attempted to structure the presentation into two main chapters: general issues and issues specifically related to WTO rules on RTAs. Where appropriate, cross-references between chapters and sections of the document are provided.

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I. REGIONAL TRADE AGREEMENTS AND THE MULTILATERAL TRADING SYSTEM: GENERAL ISSUES

A. CONVERGENCE BETWEEN REGIONAL TRADE AGREEMENTS AND THE MULTILATERAL TRADING SYSTEM

1. Both the Multilateral Trading System (MTS) and regional trade agreements (RTAs) have undergone many changes since the late 1940s, in particular since the 1980s. Through rounds of negotiations, trade liberalization has advanced significantly, while multilateral trade disciplines have acquired depth and stretched to areas well beyond the original GATT rules. At the same time, there has been a significant expansion of the number of RTAs. Trade among RTAs' parties currently accounts for over 50 per cent of global trade and covers a widening spectrum of trade policy matters. Most "new generation" RTAs cover other areas also dealt with in the WTO (e.g., standards, services, intellectual property) in addition to trade liberalization. Some may go further than WTO rules and cover subjects which have so far been excluded from, or not fully discussed in, multilateral negotiations (e.g., government procurement, investment, competition policy).

2. The number of RTAs in which at least one WTO Member participates has roughly doubled in less than ten years. The vast majority of WTO Members participate in at least one RTA: each Member (counting the European Communities as one) is on average involved in five RTAs, though some are parties to ten or more. As a consequence, there is a growing intertwining of subsets of WTO Members through RTA membership.

3. There is no common understanding among WTO Members on how these developments should be interpreted. A basic question is whether they RTAs favoured or contradicted mutual development of the MTS; that is, whether RTAs have functioned as "building blocks" or "stumbling blocks" *vis-à-vis* the multilateral process.

4. One view is that RTAs, by moving generally at a faster pace than the MTS and sharing its goals, represent a way of strengthening the latter.¹ A study conducted by the WTO Secretariat in 1998 showed that there had been a definite trend toward broader as well as faster market access liberalisation of non-tariff measures in RTAs, in parallel to developments in the MTS.² The positive effects of RTAs on the integration of developing countries in the world economy have also been emphasized by a number of Members.

5. Other Members consider that, in today's circumstances, a redefinition of the relationship between RTAs and the MTS is required, to achieve a better synergy between the two. The guiding principle in realigning the RTA/MTS relationship should be to facilitate trade between the parties and not raise barriers to third parties, as reflected in the legal texts governing regional trade agreements.³ It is argued that a further re-interpretation of the rules drafted 50 years ago would not suffice to take into account the fundamental changes observed in the nature and scope (both geographical and in terms of coverage) of RTAs and their increasingly overlapping membership. In support of this view, it has been stressed that the evolution of RTAs cannot have been foreseen by the drafters of the

¹ This view is expressed in *Regionalism and the World Trading System*, WTO Secretariat, 1995.

² *Inventory of Non-Tariff Provisions in Regional Trade Agreements*, WT/REG/W/26, para.32.

³ This principle is found in GATT Article XXIV:4; the Preamble to the Understanding on the Interpretation of Article XXIV of the GATT 1994; paragraph 3(a) of the 1979 Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries; and GATS Article V:4.

General Agreement, for which regional integration (in the form of customs unions or free-trade areas) could only appear at the time as a relatively inconsequential phenomenon.

6. In this line of thinking, delegations have raised a number of topics for further analysis:

- (a) The impact of overlapping RTA membership on trade and investment patterns, both for the parties to RTAs and third parties.

Most RTAs provide for parties' participation in other RTAs, though some set out conditions for concluding trade agreements with third countries. Overlapping networks of RTAs increase their complexity and that of their relationships with the MTS.⁴

- (a) The effects of RTAs' rules of origin (ROO) regimes.

Differing ROOs among RTAs are likely to have negative effects on trade. Complex and varying methods of determining regional content impose a significant burden on industry, which is magnified by the overlap of RTAs. On the other hand, it is argued that the "networking" of RTAs acts as a positive force for the multilateral system, as parties move toward the harmonization of rules of origin with the view to greater integration.⁵

Views are divided on how "diagonal cumulation" schemes under preferential ROO regimes affect the MTS. Users of such schemes maintain that, by simplifying and harmonizing customs procedures, diagonal cumulation reduces barriers and facilitates trade among participating economies.⁶ The counter-argument has been made that, through diagonal cumulation, the preferential nature of any individual RTA is extended to parties to other RTAs, without any legal basis;⁷ furthermore, such treatment is discriminatory, since some third parties to the original RTA – those participating in the diagonal cumulation scheme – benefit from preferential treatment, while other third parties – those not participating in the scheme – are not eligible.⁸

- (b) Difficulties resulting from changes in WTO Members' trade regimes by the enlargement of an existing RTA or its replacement by a new one.

Two questions have been raised regarding, firstly, the possible changes in WTO rights and obligations of Members acceding to a customs union⁹ and, secondly, the appropriateness of comparing the ROOs of one FTA with those of a distinct, pre-existing FTA with overlapping membership.¹⁰

- (c) The lack of accession provisions in most bilateral RTAs and the fact that Article XXIV does not impose disciplines on accession have raised doubts about the openness of RTAs and their effectiveness in contributing to the growth of world trade.

⁴ Issue recorded in WT/REG/W/12, para. 11 (see also WT/REG/W/16, paras. 57-59).

⁵ WT/REG/W/16, para. 58.

⁶ European Communities (EC), WT/REG/GEN/M/1, para. 33; Hungary and Switzerland, WT/REG/GEN/M/4, paras. 7 and 20, respectively.

⁷ United States (US), WT/REG/GEN/M/2, para. 2.

⁸ Hong Kong, China (HKC), WT/REG/GEN/M/4, para. 2.

⁹ Issues discussed in paras. 50-51 below.

¹⁰ Issue recorded in WT/REG/W/12, para. 6 (see also WT/REG/W/16, para. 22 and WT/REG4/M/2, paras. 29 and 38).

It has been proposed that disciplines be adopted at the multilateral level providing for the inclusion of flexible accession clauses in RTAs.¹¹

- (d) Need to devise means for compensation for damage caused to third parties by the creation of RTAs.¹²

According to delegations supporting this proposal, the assessment of the impact of tariff changes on the formation or enlargement of customs unions on third parties is incomplete, since it is based on a calculation of overall tariff averages, and this may be irrelevant for third parties having exports concentrated in a few sectors. They have also argued that the impact of measures other than tariffs, such as anti-dumping, preferential rules of origin, technical standards, subsidies and countervailing measures, is practically impossible to judge, at a time where their scope and importance has increased.¹³

B. INTERACTION BETWEEN TRADE POLICY DISCIPLINES ENFORCED THROUGH RTAS AND MULTILATERAL RULES

7. It has been pointed out that, with the multiplication of RTAs and growing overlapping membership, a trend has emerged towards the constitution of RTA networks, each with similar, if not identical, trade policy disciplines, developed in parallel.¹⁴ This raises a fundamental issue, namely the consequences for the multilateral legal framework of the creation of self-contained regional legal frameworks within RTAs.

8. For some Members, such a trend is likely to lead to a progressive erosion of the multilateral legal framework. Particularly, the following risks to the MTS have been identified:

- (a) The MFN principle could be increasingly bypassed by the conclusion of agreements among RTAs.¹⁵
- (b) The development of regional trade policy disciplines differing from those under the WTO Agreements could lead to Members forgoing some of their WTO rights when becoming parties to an RTA.¹⁶
- (c) Dispute settlement provisions contained in "new generation" RTAs could build jurisprudence conflicting with that of the WTO.¹⁷

One question relates to the consequences of clauses providing that, in the event of inconsistency, RTA rules prevail over WTO rules. Some Members wondered if this could result in a diminution of the rights that the parties had under the WTO in relation to their trade with one another.¹⁸ In response to this, parties to RTAs noted that language calling for their RTA to prevail in the event of inconsistency was geared toward situations in which the RTA provisions went beyond WTO disciplines,

¹¹ HKC, WT/REG/M/17, para. 34.

¹² Issue recorded in WT/REG/W/12, para. 12 (see also WT/REG/W/16, para. 23).

¹³ Pakistan, WT/REG/M/4, para. 60.

¹⁴ Issues recorded in WT/REG/W/12, paras. 9 and 11 (see also WT/REG/W/16, paras. 57-60).

¹⁵ *Supra*, footnote 13.

¹⁶ Australia, WT/REG/M/18, para. 41.

¹⁷ WT/REG4/1, questions 14-17.

¹⁸ *Ibid.*, question 15.

and that the RTA did not alter the rights and obligations of its parties with respect to each other under the WTO.¹⁹

Some Members also noted that parallel dispute settlement procedures could nullify or impair WTO rights of third parties.²⁰ This was contested on the grounds that such procedures concerned trade between the parties and not trade with third parties.²¹

- (d) Some RTAs provide for the use of competition or anti-trust policy measures in intra-trade, in cases where anti-dumping measures would apply to third parties. It has been argued that the maintenance of a dual system (of anti-dumping duties for third parties and competition policy among RTA parties) can create distortions where different criteria and conditions apply to the invocation of such measures.²²

9. Other Members have noted the potential benefits to be gathered from the development of trade disciplines in individual RTAs or RTA networks, and their application. They argue that these could provide examples for further multilateral liberalization, in particular with respect to the treatment of non-tariff measures.²³ They recognize that there is a need to find ways to coordinate different approaches to particular problem areas or trade disciplines developed regionally, so that they interact positively with the progress of multilateral disciplines in those areas. Contingency protection instruments,²⁴ technical barriers to trade (TBT) and sanitary and phytosanitary (SPS) measures²⁵ have been identified as areas to be considered in this respect, given the potential impact of such measures on third-party trade.

II. ISSUES SPECIFICALLY RELATED TO WTO RULES ON RTAS

10. WTO rules governing Members' participation in RTAs are contained in the following texts:

- Paragraphs 4-10 of *GATT Article XXIV*, and paragraphs 1-12 of the *Understanding on the Interpretation of Article XXIV of the GATT 1994* (hereinafter, the 1994 Understanding), with respect to customs unions, free-trade areas (FTAs), and interim agreements leading to a customs union or a FTA (hereinafter, interim agreements);
- Paragraphs 1, 2(c), 3(a), 3(b) and 4 of the *Decision on Differential and more Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries* (hereinafter, the Enabling Clause), with respect to reciprocal (tariff and non-tariff) preferential arrangements on trade in goods among developing countries; and
- *GATS Article V*, which deals with economic integration agreements in the area of trade in services (EIAs), including those implemented in stages.

¹⁹ *Ibid.*

²⁰ Australia and Bulgaria, WT/REG31/M/1, paras. 41 and 43, respectively.

²¹ Canada, WT/REG31/M/1, para. 42.

²² Japan, WT/REG/M/15, para. 29.

²³ Canada, WT/REG/M/14, para. 8.

²⁴ For a review of contingency instruments as provided for in a number of RTAs, see WT/REG/W/26, Annex VI, paras. 39-53.

²⁵ Background information on provisions on TBT and SPS measures in the WTO and in selected RTAs can be found in WT/REG/W/8.

A. TRANSPARENCY AND WTO REVIEW MECHANISMS FOR RTAS

1. Notification

11. All RTAs concluded by WTO Members require notification:

- (a) GATT Article XXIV:7(a): "Any [Member] deciding to enter into a customs union or free-trade area, or an interim agreement ... shall promptly notify".
- (b) Paragraph 4(a) of the Enabling Clause: "Any [Member] taking action to introduce an arrangement ... shall: notify ...".
- (c) GATS Article V:7(a): "Members which are parties to any agreement referred to in paragraph 1 shall promptly notify ...".

(i) *Timing of notifications*

12. The time at which notification of RTAs should be made is neither precisely formulated nor homogeneously expressed in the rules. Such lack of precision has been differently assessed by Members.

13. With respect to GATT Article XXIV:7(a), the following views have been put forward:

- (a) Some Members have noted that late notification has, at least partially, hindered the effectiveness of the examination process, since examination procedures cannot be launched before notification of the RTA by the parties, normally at a time when RTA provisions have already been sealed or even when the RTA is already in force.²⁶ These Members have interpreted the terms "shall promptly notify" and "deciding to enter", as articulated in subparagraph 7(a), to support the idea that notification and submission of information should take place *before* entry into force.²⁷ They have further argued that GATT Article XXIV:6 and the 1994 Understanding also point in that direction by specifying that negotiations for compensation should begin before the withdrawal of tariff concessions.
- (b) Other Members have stressed that the lack of precision in the text reflects the "pragmatism" necessary to address complex negotiations for the formation of an RTA, a particularly relevant matter in the case of large agreements in which the bulk of concessions are made at the last minute. They argue that, if the relevant WTO rules were made too strict, their effectiveness and legitimacy would be called into question.²⁸ Some Members have pointed out the political difficulty of notifying agreements before ratification.²⁹

14. The main issue discussed in relation to GATS Article V:7(a) has been whether "prompt notification" should be defined, and if so, how:

- (a) It has been proposed that a specific time-frame for implementation of the requirements in GATS Article V:7(a) be determined on a case-by-case basis.³⁰

²⁶ Canada, HKC, Japan and Korea, WT/REG3/M/1, paras. 9, 41, 42 and 44, respectively.

²⁷ Australia, HKC and Korea, Annex to WT/REG/W/5, para. 1.

²⁸ EC, WT/REG/M/4, para. 7.

²⁹ Canada and Norway, WT/REG/M/3, paras. 27 and 31, respectively.

³⁰ EC, WT/REG/M/23, para. 36.

- (b) Another view has suggested that the time-frame of "at least 90 days advance notice" as stipulated under GATS Article V:5 could serve to define "prompt notification" under GATS Article V:7.³¹ Some Members, however, have disagreed with this proposal, arguing that the 90-day notice provision under Article V:5 relates to the text in Article XXI:1 concerning modification of schedules, while GATS Article V:7 refers to a different context.³²

(ii) *Non-compliance with the notification requirement*

15. Despite the flexibility allowed to Members in the timing of the notification of RTAs, a large number of RTAs today in force have not (yet) been notified to the WTO. This is often cited as hindering any comprehensive and precise evaluation of the RTA phenomenon *vis-à-vis* the multilateral trading system.³³

16. In this respect, some Members have suggested that a means of gathering information on non-notified RTAs should be developed.³⁴ The possibility of providing for counter-notification of RTAs³⁵ has been rejected by some Members on the grounds that it would indirectly change the provisions of Article XXIV, as the WTO Agreements do not contain provisions for counter-notification on RTAs,³⁶ and that discussions of such issues are beyond the mandate of the CRTA. Other Members have argued that, in any event, it was recognized that Members could raise questions about non-notified agreements during CRTA meetings.³⁷

2. Provision of information

17. WTO Members entering RTAs are required to submit information on their agreements:

- (a) GATT Article XXIV:7(a): "Any [Member] deciding to enter into a customs union or free-trade area, or an interim agreement ... shall make available to [Members] such information regarding the proposed union or area as will enable them to make such reports and recommendations ... as they may deem appropriate."
- (b) Paragraph 4(a) of the Enabling Clause: "Any [Member] taking action to introduce an arrangement ... shall: ... furnish [Members] with all the information they may deem appropriate relating to such action."
- (c) GATS Article V:7(a): "Members which are parties to any agreement referred to in paragraph 1 ... shall also make available to the Council [for Trade in Services] such relevant information as may be requested by it."

18. The issue of provision of information has been debated mainly in the context of the examination of RTAs under GATT Article XXIV,³⁸ with Members' opinions differing with respect to both the quantitative and the qualitative nature of the statistics to be submitted by the parties.

³¹ Japan, non-paper entitled *Comments on Systemic Issues Arising from Article V of the GATS*, para. 16.

³² Argentina and New Zealand, WT/REG/M/22, paras. 16 and 17, respectively.

³³ US, WT/REG/M/2, para. 97.

³⁴ Australia, WT/REG/M/9, para. 17.

³⁵ Switzerland, Korea and Pakistan, WT/REG/M/4, paras. 5, 11 and 20, respectively.

³⁶ Mexico, WT/REG/M/4, para. 17; Peru and Venezuela, WT/REG/M/8, paras. 61 and 62, respectively.

³⁷ HKC and Japan, WT/REG/M/9, paras. 14 and 19, respectively.

³⁸ Issue recorded in WT/REG/W/12, para. 19 (see also WT/REG/W/16, paras. 28-32).

- (a) Some Members have argued that a maximum amount of statistical information is necessary, not only to assess the conformity of RTAs with WTO rules, but also to understand how the economies of parties to RTAs adjust to the evolution of trade patterns, independently from any determination about the trade creation or diversion effects of the RTA.³⁹ In support of this view, it has been noted that the 1994 Understanding states that examinations regarding the conformity of customs unions with paragraph 5 requirements should be based on "weighted average tariff rates and of customs duties collected. This assessment shall be based on import statistics for a previous representative period to be supplied by the customs union, on a tariff-line basis broken down by WTO country of origin...".
- (b) In response, it has been pointed out that not only are the detailed statistics requested by the 1994 Understanding often hard to obtain - if not unavailable – but, given that the dynamics of the economic integration are little understood, such statistics may prove misleading.

19. During individual RTA examinations, some Members requested the parties to provide statistical information also on trade they conducted under other preferential schemes. In support of these requests for data on "overlapping" preferential arrangements, it has been argued that, from a horizontal and/or economic point of view, such information is vital to understanding the relationship between RTAs and the multilateral trading system and is difficult to obtain in another setting.⁴⁰ The parties to the individual RTA being examined have typically responded that no legal obligation exists to supply information beyond the scope of that particular examination.⁴¹

3. Examination and WTO compatibility of RTAs

20. The examination of an RTA by WTO Members is viewed as both promoting transparency and setting the ground for conclusions on the RTA's consistency with the relevant rules, which might lead to "appropriate" recommendations to the parties.

21. Given the fact that only one of the reports on the examination of RTAs adopted to date (the Czech Republic-Slovak Republic Customs Union) states clearly that the RTA is fully compatible with the relevant GATT rules, the legal status of RTAs within WTO rules is controversial:

- (a) Some Members have expressed the view that, even if clear conclusions are not spelled out, the mere fact of having concluded an examination and adopted a report that contains no recommendations to the parties to the agreement means that such RTAs are tolerated or deemed compatible by the WTO.⁴² Further, the fact that such RTAs have not been subject to dispute settlement indicates that the economic facts might not support the claims made of trade diversion effects.⁴³
- (b) Others have argued that the legal status and value of an RTA remains unclear in the absence of a conclusive report and that in any event the rights of WTO Members under dispute settlement procedures are preserved.⁴⁴

³⁹ Canada, WT/REG/M/15, para. 26.

⁴⁰ US, WT/REG12/M/2, para. 26.

⁴¹ Norway, WT/REG12/M/2, para. 30.

⁴² The view that RTAs are simply "tolerated" by the WTO has been rejected on the grounds that Article XXIV provides a right for Members to form such agreements (EC, WT/REG/M/1, para. 29).

⁴³ Switzerland, WT/REG/M/15, para. 28.

⁴⁴ HKC, WT/REG/W/19, paras. 4-5.

22. In the dispute *Turkey – Restrictions on Imports of Textile and Clothing Products* (hereinafter, the *Turkey-Textiles* case), the Panel examined an argument put forward by Turkey, along the same line as the views reported in sub-paragraph (a) above. The Panel agreed with the findings of the GATT Panel in *EEC - Imports from Hong Kong*, which rejected a similar argument put forward by the European Communities (EC), stating that "... it would be erroneous to interpret the fact that a measure had not been subject to Article XXIII over a number of years, as tantamount to its tacit acceptance by contracting parties".⁴⁵

23. At issue also is with whom lies the burden of proof of WTO compatibility of RTAs:

- (a) One view is that it is the parties' responsibility to prove that they are in compliance with the relevant provisions, on the basis of the practice in international law, where the invocation of a treaty provision having an exceptional character places the burden of proof to demonstrate compatibility on the party invoking the exception.⁴⁶
- (b) Other Members have stated that it was the task of Members not party to the RTA to prove that the RTA did not comply with Article XXIV,⁴⁷ as no country would enter into an RTA with a clear intention to breach its WTO obligations by agreeing to provisions that ran counter to the obligations of Article XXIV.⁴⁸

24. In the *Turkey-Textiles* case, the Panel recalled the well-established WTO rules on burden of proof, whereby "... (b) it is for the party invoking an exception or an affirmative defense to prove that the conditions contained therein are met" and "... (c) it is for the party asserting a fact to prove it". Hong Kong, China (as a third party in the case) argued that "since Article XXIV was an exception invoked by Turkey, it was for Turkey to bear the burden of proof".⁴⁹ In the same case, the Appellate Body stated: "[w]e would expect a panel, when examining such a measure [taken by a party to a customs union], to require a party to establish that both of these conditions [the customs union fully meets the requirements of XXIV:8(a) and 5(a) and that without such measure that customs union could not be formed] have been fulfilled"⁵⁰ (see also paragraph 28 below).

4. Periodic reporting

25. GATS Article V:7(b) requires the parties to an EIA implemented on the basis of a time-frame to "report periodically" to the Council for Trade in Services on its implementation. Some Members have proposed that periodic reporting should be extended to all EIAs, whether or not implemented in stages.⁵¹ A differing view was that a modification of reporting requirements would require a renegotiation of GATS provisions and that it was more appropriate to focus on existing obligations within GATS Article V.⁵²

⁴⁵ Panel Report on *EEC – Quantitative Restrictions against Imports of certain Products from Hong Kong*, adopted on 12 July 1983 (BISD 30S/129), para. 28, and Panel Report on *Turkey- Textiles*, adopted on 19 November 1999 (WT/DS34/R), paras. 9.172-174.

⁴⁶ HKC and Japan, WT/REG/M/16, paras. 68 and 127, respectively.

⁴⁷ The parties to the RTA would however provide sufficient information to allow the other Members to make their assessment.

⁴⁸ Hungary, WT/REG/M/16, para. 122.

⁴⁹ WT/DS34/R, paras. 9.57 and 9.58.

⁵⁰ Appellate Body Report, adopted on 19 November 1999 (WT/DS34/AB/R), para. 59.

⁵¹ In parallel to the obligation on goods agreements as reflected in paragraph 11 of the 1994 Understanding (Japan, non-paper referred to in footnote 31, para. 16(b)).

⁵² US and the EC, WT/REG/M/23, paras. 11 and 13, respectively.

B. COHERENCE AMONG RTA-SPECIFIC WTO DISCIPLINES AND BETWEEN THEM AND OTHER WTO RULES

1. GATT Article XXIV and the WTO Agreements in the area of goods⁵³

26. During the Uruguay Round, Members sought to clarify a number of provisions contained in the original GATT Article XXIV drafted in 1947.⁵⁴ One of the issues then submitted for consideration was the definition of the terms "other [than duties] regulations of commerce" as used in Article XXIV:5, but no consensus was reached on it.⁵⁵ This implied that the relationship between Article XXIV provisions with respect to non-tariff matters remained open to debate, at a time when the distance between the original GATT disciplines and those embodied in the WTO Agreements was growing.

27. In CRTA discussions, two distinct lines of thinking have emerged concerning the overall relationship between Article XXIV and other WTO provisions:

- (a) Article XXIV should be considered as a derogation only from Article I of the GATT 1994; parties to RTAs must abide by all other WTO provisions.

According to this view, Article XXIV provides no additional rights to RTA parties and should not therefore be used as a legal cover for otherwise GATT-inconsistent measures or trade policies which the parties to RTAs might take or maintain; the exceptional status of Article XXIV should be understood in the light of RTAs' building-block function of furthering multilateral liberalization.⁵⁶

- (b) Article XXIV should be considered as a derogation from all the provisions of the GATT 1994, and not merely from the MFN principle.

Delegations holding this view note that the opening sentence of Article XXIV:5 refers to the "provisions of the Agreement", not to any one or any defined number of particular provisions of the Agreement. Thus, Article XXIV is a derogation from all provisions of the Agreement, not just Article I. Further, international law on multilateral treaties generally holds that parties to a multilateral agreement can form subsequent agreements between a subset of the membership of the wider agreement, varying their rights and obligations between themselves, provided they do not abridge the rights of third countries to the wider, underlying agreement. According to this view, the act of joining an RTA does not modify any of the rights and obligations of a Member towards other Members under WTO instruments, as illustrated by the fact that the assumption of Article XXIV:5 is that parties to RTAs can resort to all of the regulations of commerce available to them under the various WTO instruments in the conduct of their commercial relations with third countries. That would mean, for example, that measures in the context of an RTA could differ from the relevant WTO provisions, provided they do so in a manner that does not diminish the rights of third parties.⁵⁷

⁵³ Issue recorded in WT/REG/W/12, para. 22 (see also WT/REG/W/16, paras. 51 and 52).

⁵⁴ The results of the negotiations are contained in the 1994 Understanding.

⁵⁵ In turn, only in one instance did the Agreements concluded in 1994 on non-tariff matters in the goods area refer specifically to RTAs (i.e. footnote 1 to Article 2.1 of the Agreement on Safeguards).

⁵⁶ Korea, WT/REG/M/14, para. 10; HKC and India, WT/REG/M/15, paras. 48 and 61, respectively; and Japan, WT/REG/M/16, para. 64.

⁵⁷ EC, who also stated that this was balanced to some extent by the requirement that the incidence of duties and other regulations should not increase as a result of the formation of the RTA (WT/REG/M/14, para. 13 and WT/REG/M/15, para 54).

28. In the *Turkey-Textiles* case, the Panel found that Article XXIV did not authorize a departure from GATT/WTO obligations other than Article I of the GATT.⁵⁸ The Appellate Body considered such conclusion to be erroneous and found that "Article XXIV may justify a measure which is inconsistent with certain other GATT provisions. However, in a case involving the formation of a customs union, this "defence" is available only when two conditions are fulfilled. First, the party claiming the benefit of this defence must demonstrate that the measure at issue is introduced upon the formation of a customs union that fully meets the requirements of sub-paragraphs 8(a) and 5(a) of Article XXIV. And, second, that party must demonstrate that the formation of that customs union would be prevented if it were not allowed to introduce the measure at issue. Again, *both* these conditions must be met to have the benefit of the defence under Article XXIV".⁵⁹

29. The relationship between Article XXIV and other WTO provisions is also reflected in the discussions of the Council for Trade in Goods (CTG), at the time of adoption of the first terms of reference for the examination of an RTA in the WTO.⁶⁰ The mandate for examination of RTAs normally reads as follows: "to examine, in light of the relevant provisions of the GATT 1994 ...". Since this terminology refers only to the GATT 1994 and does not specify whether the examination may also be carried out against the background of all WTO Agreements relating to trade in goods, it was agreed to expand the terms of reference through an understanding, whereby Members have "... the mandate to examine the incidence and restrictiveness of all duties and regulations of commerce, in particular those governed by the provisions of the Agreements contained in Annex 1A of the WTO Agreement ... [but] that the purpose of an examination in the light of paragraph 5(a) of Article XXIV would not be to determine whether each individual duty or regulation existing or introduced on the occasion of the formation of a customs union is consistent with all provisions of the WTO Agreement; it would be to ascertain whether on the whole the general incidence of the duties and other regulations of commerce has increased or become more restrictive. Accordingly, although the Working Party would conduct its examination in light of the relevant provisions of the Agreements contained in Annex 1A of the WTO Agreement, the conclusions of the Report of the Working Party would be confined to reporting on consistency with the provisions of Article XXIV".⁶¹ These terms of reference (including the understanding) became standard for all subsequent examinations of RTAs notified under GATT Article XXIV.

30. A number of related questions were raised during examinations:

- Are parties to an RTA allowed to grant each other preferential treatment falling short of free trade?⁶²
- Is the introduction of new quantitative restrictions justifiable in the context of GATT Articles XXIV:5 and XXIV:8(a)(ii) in the case of a customs union?⁶³ The Appellate Body findings in the *Turkey-Textiles* case, reported in paragraph 28 above, are of relevance to that point.
- How should anti-dumping/safeguard measures already in place within an RTA be applied by new parties to that RTA?⁶⁴
- Since no multilaterally agreed methodology exists, how should individual Members' reduction commitments on domestic support and export subsidies be translated into common commitments when a customs union is established or enlarged?⁶⁵

⁵⁸ WT/DS34/R, paras. 9.186-9.188.

⁵⁹ WT/DS34/AB/R, para. 58.

⁶⁰ The enlargement of the EC to include Austria, Finland and Sweden.

⁶¹ See WT/REG3/1. This same understanding applies *mutatis mutandis* to FTAs.

⁶² Issue recorded in WT/REG42/M/2, para. 7.

⁶³ Issue recorded in WT/REG/W/12, para. 21 (see also WT/REG/W/16, para 50(b)).

⁶⁴ *Ibid.*, paras. 5(b) and 50(c), respectively.

⁶⁵ *Ibid.*, paras. 5(c) and 50(a), respectively.

31. Another issue discussed in the CRTA relates to the linkages which may be drawn between RTA provisions on ROOs, the "other regulations of commerce" (ORCs) concept in Article XXIV and the Common Declaration With Regard to Preferential Rules of Origin, annexed to the WTO Agreement on Rules of Origin. Members' views in this respect have been as follows:

- (a) Some Members have observed that the word "preferential" is fundamental, as ROOs in an RTA are not designed to decide the country of origin for the purposes of MFN trade; their purpose is to determine whether goods qualify for preferential treatment in intra-RTA trade.⁶⁶ In that sense, preferential ROOs do not constitute an ORC⁶⁷ as by definition they do not affect trade with third parties.
- (b) Others have pointed out that, while Article XXIV offers no definition of ORCs, there is a broad understanding that ORCs refer to all measures (other than tariffs) affecting the conduct of trade. The fact that the WTO Agreement on Rules of Origin links ROOs to trade measures in two instances has also been cited as providing the ground for a possible connection between preferential ROOs and ORCs.⁶⁸ On the other hand, it has been noted that recent Panel findings have made broad interpretations of the scope of measures that affect trade.⁶⁹
- (c) It has been noted that preferential ROOs encourage a higher degree of integration within an RTA than prior to such an agreement and that trade diversion is likely to result as, in order to benefit from preferential treatment, companies within the RTA will tend to increase local sourcing with adverse effects on market opportunities for outside suppliers. Given the close relationship between international trade and investment, preferential ROOs thus work as an effective incentive for a third country company to invest within an RTA. Further, the complexity of preferential ROOs often results in them becoming a barrier to trade *per se*.⁷⁰
- (d) It has been suggested that in many instances a case-by-case evaluation of the preferential ROOs would clearly indicate whether they had restrictive effects on the trade of the RTA with third parties.⁷¹ For example, if there had previously been no preferential ROOs, the very introduction of such rules would imply that the degree of restriction had increased. The same would be assumed if the preferential ROOs called for greater regional content than the rules previously in force. A subsequent question would be what to do in such cases.⁷²

2. RTAs notified under the Enabling Clause

32. The notification of RTAs under the Enabling Clause has been described as a systemic issue, but no substantive debate has taken place on it.⁷³ Broader issues surrounding this particular question

⁶⁶ HKC, WT/REG/W/27.

⁶⁷ US, WT/REG/M/15, para. 59.

⁶⁸ The preamble to the Agreement recognizes that clear and predictable rules of origin and their application facilitates the flow of international trade, and states the desirability that rules of origin themselves do not create unnecessary obstacles to trade. The Common Declaration annexed to the Agreement provides disciplines for preferential rules of origin; in particular, Article 3(c) requires that laws and regulations relating to preferential ROOs be published "as if they were subject to, and in accordance with, the provisions of Article X of GATT 1994".

⁶⁹ Korea, WT/REG/M/18, para. 23.

⁷⁰ *Ibid.* and Japan, WT/REG/W/28-29.

⁷¹ Japan, WT/REG/W/28, Section I.

⁷² Korea, WT/REG/M/18, para. 24.

⁷³ Issue recorded in WT/REG/W/12, para. 16 (see also WT/REG/W/16, para. 27).

appear to be related both to the relationship between disciplines under the Enabling Clause and GATT Article XXIV, and to the adequacy of WTO surveillance of RTAs among developing countries.⁷⁴

3. GATS Article V and the rest of the GATS

33. In the area of trade in services, one critical issue has also been the precise scope of the exemption for EIAs provided by the Article. In this respect, some Members have maintained that Article V is not intended to create departures from anything other than the MFN obligations of the GATS;⁷⁵ it has been considered that an EIA should not be allowed to derogate from the key principles of the GATS, such as transparency and the fair administration of domestic regulations, as well as from disciplines on emergency safeguards.

C. LINKAGES WITHIN RTA-SPECIFIC WTO DISCIPLINES

1. GATT Article XXIV

(i) *Relevance and scope of paragraph 4 vis-à-vis other Article XXIV provisions*⁷⁶

34. Article XXIV:4 contains concepts that are reaffirmed in the fifth paragraph of the Preamble to the 1994 Understanding. The nature of the relationship between these propositions and other paragraphs of Article XXIV has been debated within the CRTA from different angles, and a number of controversial issues were identified. A first issue refers to whether Article XXIV:4 contains additional requirements to those specified in paragraphs 5-8 or should be viewed as merely introducing these provisions:

- (a) Members supporting the view that paragraph 4 contains such additional requirements read the Preamble to the 1994 Understanding not as acknowledging that RTAs' contribution to the expansion of world trade is automatic, but as linking this contribution to the trade coverage of the RTA. The words "*inter alia*" in paragraph 1 of the 1994 Understanding are seen as indicating that there are other criteria than those contained in paragraphs 5-8 - which provide for internal and external tests - for determining the consistency of an RTA with GATT 1994. These Members also claim that the second sentence of paragraph 4 would permit a trade creation/diversion test, in consideration of the overriding concern for not raising barriers in the context of the primacy of the MTS.⁷⁷
- (b) For those Members endorsing the view that paragraph 4 has a purely introductory nature, this paragraph spells out the general principles under which Members can derogate from Article I of GATT 1994. They maintain that Article XXIV requires RTA parties to meet the fundamental criteria of facilitating intra-trade and no increase in barriers for trade with third parties, if they are to benefit from the derogation contained in the opening sentence of paragraph 5.⁷⁸ The first criterion is regulated in

⁷⁴ During past debates in the GATT, it had been argued on one side that the Enabling Clause was not appropriate to deal with such RTAs which took the form of either FTAs, customs unions or interim agreements, but rather Article XXIV. On the other side, it was said that trade agreements among developing countries were covered by the Enabling Clause (see, for example, discussions reported under item 13 of C/M/254 and item 9 of C/M/255).

⁷⁵ New Zealand and Japan, WT/REG/M/22, paras. 17 and 18, respectively.

⁷⁶ Issue recorded in WT/REG/W/12, para. 3 (see also WT/REG/W/16, paras. 5-8).

⁷⁷ This has been supported to varying degrees by Australia, India, HKC, Japan and Korea (WT/REG/M/15). See also Australia, WT/REG/W/25, paras. 5 and 8, for a further discussion.

⁷⁸ It is noted that the language in Article XXIV:4 is in both instances "should be", and not "is" to facilitate trade or not to raise barriers.

paragraph 8, while possible RTA effects on third-party trade are to be considered in light of the provisions of paragraph 5, which seek to guarantee overall equality of opportunity before and after the formation of an RTA. These Members also argue that, by referring to all the provisions of paragraphs 5 to 8, paragraph 1 of the 1994 Understanding merely indicates where are to be found the criteria that an RTA should meet to fulfil the guidance presented in paragraph 4. In their view, therefore, paragraph 4 does not justify other tests for the conformity of RTAs, including any trade creation/diversion test.⁷⁹ They also contend that, since in market economies the creation or diversion of trade relies on the interplay of economic forces beyond governments' control, Members can only be required to facilitate intra-RTA trade and not to increase barriers to trade with third parties. They also point to the difficulty in measuring trade creation and trade diversion accurately.

35. The Appellate Body Report in the *Turkey-Textiles* case states that "Paragraph 4 contains purposive, and not operative, language. It does not set forth a separate obligation itself but, rather, sets forth the overriding and pervasive purpose for Article XXIV which is manifested in operative language in the specific obligations that are found elsewhere in Article XXIV".⁸⁰

36. On the relationship between the phrase "not to raise barriers" towards third parties contained in paragraph 4 and the corresponding concept in paragraph 5, opinions within the CRTA again fall into two distinct camps where customs unions are concerned (sub-paragraph 5(a)):

- (a) Some maintain that, in such a case, only the net effect of the barriers on third parties is to be considered: while an increase in the overall level of barriers is clearly not permitted, parties are not bound by an obligation not to raise any barrier.⁸¹
- (b) Others see the phrase "not to raise barriers" not only as an attempt to maintain a standstill in overall barriers against third parties but as preventing any new barriers from being raised.⁸²

37. In the *Turkey-Textiles* case, the Panel found that "What paragraph 5(a) provides, in short, is that the effects of the resulting trade measures and policies of the new regional agreement shall not be more trade restrictive, overall, than were the constituent countries' previous trade policies" and that paragraph 5(a) provided for an "economic" test for compatibility; both these findings were shared by the Appellate Body.⁸³ The Appellate Body also states the need for the text of the chapeau of paragraph 5 to be interpreted in its context, which, as indicated by the word "accordingly" at the beginning of the paragraph, can only be read to refer to paragraph 4; since the purpose of a customs union is "to facilitate trade" between the constituent members and "not to raise barriers to the trade" with third countries, "a balance [must] be struck by the constituent members of a customs union".⁸⁴

38. Finally, there is the question of the relative precedence of provisions in paragraphs 4-5 and those in paragraph 8, in a case where a measure ostensibly taken within an RTA to facilitate intra-trade

⁷⁹ EC, WT/REG/M/15, para. 12. Argentina, Brazil, Canada and the US also share this view (WT/REG/M/15).

⁸⁰ WT/DS34/AB/R, para. 57.

⁸¹ Argentina and EC, WT/REG/M/15, paras. 15 and 36, respectively; Turkey, WT/REG/M/16, para. 54.

⁸² Australia, WT/REG/M/14, para. 18; HKC and Australia, WT/REG/M/15, paras. 14 and 31, respectively. The last sentences regarding regionalism of the Singapore Ministerial Declaration were cited in support of the view that Article XXIV language provided for a positive liberalization and not merely for neutrality (HKC, WT/REG/M/15, para. 30).

⁸³ WT/DS34/R, para. 9.121 and WT/DS34/AB/R, para.55.

⁸⁴ WT/DS34/AB/R, para. 56.

would have a trade-restrictive effect on third parties. This issue was raised in particular with respect to the possible impact of compliance with the requirement concerning common trade policy in a customs union contained in subparagraph 8(a)(ii):

- (a) One view was that, in such a situation, consistency should be measured not only against the criteria contained in paragraph 8 and then in paragraph 5, but also against the principles contained in the last sentence of paragraph 4. It was thought that, otherwise, parties to a customs union would acquire new rights, i.e. would be permitted to apply restrictive measures above those which they would have been able to apply if the customs union had not been established.⁸⁵
- (b) Opposing that view both on general grounds and in relation to customs unions, some Members noted that in the case of customs unions, though every instrument or measure adopted in the course of the process to put in place a common trade policy might not be trade promoting, subparagraph 5(a) recognized such flexibility by only requiring duties and ORCs not to be higher or more restrictive "on the whole".⁸⁶

39. Some findings of the Panel and the Appellate Body in the *Turkey-Textiles* case, such as those reported in paragraphs 35 and 37 above, may shed light on that issue.

(ii) *Differences in paragraph 5 rules applying to customs unions and FTAs*⁸⁷

40. Paragraph 5 of Article XXIV provides for an assessment of the conditions of third countries' access to the markets of the parties to an RTA, before and after the formation of the relevant RTA. The basis for such an assessment in the case of customs unions is found in subparagraph (a), and in the case of FTAs in subparagraph (b).

41. The language used in these two provisions is largely symmetrical, but it contains some differences which gave rise to divergent views within the CRTA. Subparagraph 5(a) states that the duties and ORCs "imposed" by a customs union are to be compared to those "applicable" by its parties prior to the institution of the union. Paragraph 2 of the 1994 Understanding clarifies the meaning of the words "imposed" and "applicable" with respect to duties, by specifying that, in the context of the general incidence calculation, "... the duties and charges to be taken into consideration shall be the applied rates of duty".

42. The corresponding language used in subparagraph 5(b) for FTAs states that the comparison is to be made between the duties and ORCs "maintained in each of the constituent territories and applicable at the formation" of the FTA and those previously "existing in the same constituent territories". Members have put forward different views with respect to the differences in these terms. With respect to duties, while some have argued that the "applicable" duties for FTAs refer to *bound* rates,⁸⁸ others have contended that they refer to *applied* rates. By pointing to the 1994 Understanding, the proponents of a stricter definition have claimed that a consistent interpretation of paragraph 5 would require that duties "applicable" by an FTA refer to applied rates just like in the case of a customs union.⁸⁹

⁸⁵ Korea, WT/REG/M/14, para. 10; Japan, WT/REG/M/16, para. 59

⁸⁶ Argentina, WT/REG/M/15, para. 15; Turkey and EC, WT/REG/M/16, paras. 54 and 63, respectively.

⁸⁷ Issues recorded in WT/REG/W/12, paras. 2(a)-(b) (see also WT/REG/W/16, paras. 14-17 and 19-21).

⁸⁸ EC, WT/REG1-2,7-9/M/1-2, paras. 57 and 14, respectively.

⁸⁹ Korea, WT/REG1-2,7-9/M/2, para. 19.

43. Another issue raised in that context related to the definition of ORCs itself. It has been noted that, under Article XXIV:5, the term might have a wider scope for FTAs than for customs unions.⁹⁰ Thus, for example, some Members have argued that ROOs should be considered as one of the ORCs in the context of Article XXIV:5(b), for FTAs.⁹¹

44. It has also been pointed out that a major difference between subparagraph 5(a), which deals with customs unions and 5(b), which deals with FTAs, is the absence of the phrase "on the whole" in the latter. While this expression has led to differing interpretations of 5(a) with respect to customs unions, its absence from 5(b) for FTAs has led some to seek a more straightforward interpretation of the requirements therein, so as to preclude any increase in MFN duties or ORCs at the formation of an FTA.⁹²

(iii) Relationship between paragraph 5 and paragraph 8 provisions

45. Article XXIV provides no definition of "other restrictive regulations of commerce" (ORRCs) as specified in paragraph 8(a). Most of the discussion has focused on whether safeguard and anti-dumping measures should be considered as ORRCs.

46. It has been generally recognized that paragraph 8 deals mainly with those measures that are internal to the customs union or FTA, whereas paragraph 5 governs external relations, and that the former paragraph describes the minimum parameters which an RTA must meet. Notwithstanding this, it has been pointed out that RTAs' internal disciplines might result in the raising of barriers to the trade of third parties; hence the need to analyze the intent and application of ORRCs in operation in RTAs.⁹³ The application or harmonization of standards (both TBT and SPS),⁹⁴ as well as the introduction and enforcement of competition laws,⁹⁵ were cited as possible fields where this could apply.

(iv) Applicability of provisions related to RTAs implemented by stages⁹⁶

47. In the GATT/WTO history, though most customs unions or FTAs have been, at least in part, implemented by stages, only a few have expressly been notified as "interim agreements". This reflects differing views among Members on what may be understood as an interim agreement in the sense of Article XXIV and the 1994 Understanding. This has affected the relevance of the relatively large number of criteria specifically devoted to this type of RTA,⁹⁷ and may have complicated the search for solutions to some contested aspects of other Article XXIV provisions.

48. A few specific issues have been raised in the CRTA with respect to the application of the requirements on interim agreements:

- (a) It has been argued that the transitional period (10 years) characterized as a "reasonable length of time" in paragraph 3 of the 1994 Understanding could refer to

⁹⁰ This mainly as a result of the fact that, in the formation of a customs union, what was involved was the substitution of a single customs territory for multiple ones.

⁹¹ Japan, WT/REG/W/29, para. 5-7; HKC, WT/REG/W/31, section 5.ii.(e). Issue recorded in WT/REG/W/12, para. 2(b) (see also WT/REG/W/16, para. 19).

⁹² Turkey, WT/REG/M/16, para. 54; US, WT/REG1-2,7-9/M/1, para. 19; Japan, WT/REG42/M/1, para. 18.

⁹³ Some Members argued that what is important is whether the application of some specific measures among RTA parties led to restrictions on the trade of third parties, and not whether they constituted ORRCs.

⁹⁴ For a hypothetical example, see Australia, WT/REG/W/25, para. 10.

⁹⁵ WT/REG/W/25, para. 10.

⁹⁶ Issues recorded in WT/REG/W/12, paras. 10 and 13 (see also WT/REG/W/16, paras. 33-35).

⁹⁷ Paras. 5(c), 7(b) and 7(c) of GATT Article XXIV and paras. 3 and 8-10 of the 1994 Understanding.

individual products and that the obligation "to exceed 10 years in exceptional cases" could be used to justify a longer transition period for some products, if such products constitute a very small percentage of trade.⁹⁸ According to this view, parties to an RTA might apply a longer transition period to some products instead of excluding them from the scope of the agreement straightaway; that would allow that substantially all the trade be covered within 10 years. That argument has been contested on the grounds that the "reasonable period of time" refers to the plan and schedule, not to individual products.⁹⁹

- (b) What should be expected as a "full explanation" by parties to an interim agreement with transitional periods longer than 10 years?
- (c) When should interim agreements fulfil the requirements spelled out in paragraphs 5 and 8: at the time of entry into force of the interim agreement or when the RTA has been fully implemented?

It has been argued that, in the context of paragraph 8, the requirements (in particular with respect to "substantially all the trade") should apply only at the end of the transition period; while paragraph 5 requirements should apply both during and at the end of the transition period.¹⁰⁰ Members supporting this argument have noted that paragraph 8, which defines customs unions and FTAs but not the steps along the way to their achievement, involve essentially a prospective test, while such interpretation of the application of paragraph 5 requirements provided an important protection for the rights of third parties during the transition period. It has been proposed that this factor be taken into account especially when discussing ORCs in the context of paragraph 5.

- (d) Should there be a distinction in the treatment of ORRCs and ORCs between fully implemented RTAs and interim agreements?

On the basis of arguments similar to those under (c) above, some Members have advocated such a distinction in treatment by maintaining that certain trade policy measures were needed only for the management of the transitional process and could therefore be applied in the context of interim agreements but not in fully implemented customs unions or FTAs.

2. GATS Article V

49. Different views have been offered in relation to the nature of the link between "substantial sectoral coverage" (subparagraph 1(a)) and "substantially all discrimination" (sub-paragraph 1(b)):

- (a) One is that if a sector meets the test of Article V:1(b), it should be considered also to be covered for purposes of Article V:1(a); conversely, that the sector would be considered as not covered if it did not satisfy the requirements under Article V:1(b).
- (b) Another is that the two tests are separate, with Article V:1(a) having been designed to determine the proportion of sectors or subsectors that would be subject to liberalization under an EIA, while Article V:1(b) seeks to determine whether any policy measures that retain a degree of discrimination in liberalized sectors, activities, or modes of supply are acceptable. In support of this view, it has been stated that the

⁹⁸ NAFTA Parties, WT/REG4/1 and Add.1, responses to questions 23 and 24.

⁹⁹ EC, WT/REG4/M/4, para. 28.

¹⁰⁰ EC and Argentina, WT/REG/M/15, paras. 36 and 37, respectively.

footnote in Article V:1(a) makes no reference to the requirement of Article V:1(b) for the "absence of elimination or substantially all discrimination" in complying with its own provisions; furthermore, the exemptions listed in Article V:1(b) imply that this provision is meant to deal with discriminatory measures of general application that remain in effect after the application of the liberalization provisions of the EIA.¹⁰¹

Thus, it is suggested, a sector need not meet the requirements of Article V:1(b) in order to be considered as covered for purposes of Article V:1(a). For example, while the *a priori* exclusion of any mode of supply by an EIA would call into question its compliance with Article V, the parameters defined in the footnote do not imply that the agreement must contain within it an investment agreement that extends national treatment.¹⁰²

D. INTERPRETATION OF CONCEPTS AND PROVISIONS CONTAINED IN GATT ARTICLE XXIV AND THE 1994 UNDERSTANDING

1. Article XXIV:8

50. While the status of a WTO Member remains unchanged by the mere fact that it becomes party to an FTA, the legal standing of WTO Members which become parties to a customs union seems less clear:

- (a) One view states that customs territories become a new legal entity when forming a customs union, on the ground that a new commercial policy *vis-à-vis* third countries is then established, in accordance with subparagraph 8(a)(ii). It is argued that Article XXIV:5 also captures that idea, since there the word "imposed" is used in the context of a customs union, which conjures up something new, while the word "maintained" can be found with reference to an FTA, where there is continuity of the original customs territories.¹⁰³
- (b) Others state that, notwithstanding the requirement in subparagraph 8(a) to substitute a single customs territory for two or more customs territories, WTO obligations continue to subsist and operate at the level of the original customs territories.¹⁰⁴

51. In the *Turkey-Textiles* case, the Panel did not agree with the argument that a WTO right pertaining to a constituent member prior to the formation of a customs union could be "passed" or "extended" to other constituent members. The Panel noted that "... even if the formation of a customs union may be the occasion for the constituent member(s) to adopt, to the greatest extent possible, similar policies, the specific circumstances which serve as the legal basis for one Member's exercise of such a specific right cannot suddenly be considered to exist for the other constituent members. We also consider that the right of Members to form a customs union is to be exercised in such a way so as to ensure that the WTO rights and obligations of third country Members (and the constituent Members) are respected, consistent with the primacy of the WTO, as reiterated in the Singapore Declaration".¹⁰⁵

¹⁰¹ HKC, non-paper entitled *Systemic Issues arising from Article V of the GATS*, para. 2.

¹⁰² New Zealand, WT/REG/M/22, para. 17.

¹⁰³ EC, WT/REG/M/15, para. 44.

¹⁰⁴ HKC, WT/REG/M/15, paras. 38 and 48.

¹⁰⁵ WT/DS34/R, paras. 9.183-184.

(i) *Subparagraphs (a)(i) and (b)*

52. These subparagraphs are intended to define what should be understood by "customs union" and by "free-trade area", respectively. In this context, subparagraph (a)(i) requires that duties and, apart from permissible exceptions,¹⁰⁶ ORRCs be "eliminated" with respect to "substantially all the trade" between the parties of a customs union "or at least ... substantially all the trade" in originating products. A similar requirement is contained in subparagraph (b) for FTAs: that such elimination be made on "substantially all the trade" in originating products.

53. Two issues have blocked the assessment of RTAs' fulfilment of these requirements: the meaning of "substantially all the trade" (SAT),¹⁰⁷ and the scope of the list of ORRC exceptions.

54. Lack of consensus on the meaning of SAT¹⁰⁸ has repeatedly led examinations of RTAs to an impasse. Despite the inclusion of the fourth paragraph in the Preamble to the 1994 Understanding,¹⁰⁹ this issue has remained contentious. Typically, since the GATT years, there have been two approaches, not mutually exclusive, to the interpretation of SAT:

- (a) *A quantitative approach*, favouring the definition of a statistical benchmark, such as a certain percentage of the trade between the parties, to indicate that the coverage of a given RTA fulfils the SAT requirement.

Arguments put up against this approach include the view that a single numerical definition or threshold cannot suit the different contexts in which the word "substantially" is used within paragraph 8, and that, whatever the quantitative figure set for coverage, it could essentially be giving a licence to exclude a set amount of trade.

- (b) *A qualitative approach*, according to which the SAT requirement means that no sector (or at least no major sector) was to be kept out of intra-RTA trade liberalization. Under this approach, SAT is viewed as preventing the exclusion of any sector where the amount of trade was small before the formation of the RTA due to the restrictive policies in place, as would be the case if a quantitative approach was used.

One argument made against this view is that an RTA which lists all sectors as being subject to liberalization may not necessarily satisfy Article XXIV:8, because this does not automatically result in free trade

55. A number of suggestions have been made in the CRTA, in an attempt to bridge or complement those approaches:

- (a) To link RTAs' compatibility with the SAT requirement to a product coverage defined in terms of a certain percentage of tariff lines, and not only in terms of trade flows. In this context, a threshold has been proposed at 95 per cent of all HS tariff lines at the six-digit level, to be complemented by an assessment of prospective trade flows at various stages of implementation of the RTA, thereby allowing the incorporation of cases where trade is initially concentrated in relatively few products.¹¹⁰

¹⁰⁶ "... (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) ...".

¹⁰⁷ Often also referred to as an RTA's "product coverage".

¹⁰⁸ Issue recorded in WT/REG/W/12, para. 17 (see also WT/REG/W/16, paras. 40-44; WT/REG/W/21/Rev.1 and WT/REG/W/21/Add.1.).

¹⁰⁹ "Recognizing also that such contribution ... if any major sector of trade is excluded".

¹¹⁰ Australia, WT/REG/W/22/Add.1, paras. 9-10.

- (b) To refine the quantitative approach to the SAT requirement by taking into account the use of preferential rules of origin in trade among the parties to an RTA.

In practice, this refinement would consist in calculating the percentage represented by trade flows carried out under preferential rules of origin in all trade between the RTA parties. It has been argued that, in this way, the less stringent the preferential ROOs of an RTA, the higher the percentage of intra-RTA trade which would be incorporated into the SAT threshold.¹¹¹

- (c) To define RTAs' coverage as meaning that all sectors should be included.

The rationale behind this proposal is that the SAT concept, formulated in the GATT 1947, is not as such applicable in the present GATT 1994 context which is built upon the idea of a single undertaking, where all provisions are mandatory and where the extent and depth of coverage of the MFN obligations is much wider.¹¹² This argument has been contested on the ground that although the economic and legal contexts might have changed, the interpretation of terms has not.¹¹³ Additionally, the meaning of "substantially" could only be understood to mean "not the whole".¹¹⁴

- (d) To explore whether footnote 1 to GATS Article V provides a basis for some clarification of the SAT concept.¹¹⁵

56. Members have held differing views on whether measures under the Articles cited in the list of permitted exceptions are the only ones which parties to an RTA can still apply to the trade covered by the agreement. Discussions on the scope of the list of ORRC exceptions¹¹⁶ have focused on the application of anti-dumping measures and, in particular, of safeguards, since neither Article VI nor Article XIX are cited as permitted exceptions in the list.

57. Given that anti-dumping measures are, by nature, discriminatory, it has been argued that the issue of the MFN application of anti-dumping duties does not arise since only the alleged dumping countries or exporters are targeted.¹¹⁷ However, the fact that, in their mutual trade, parties to some RTAs use competition or anti-trust policy measures, rather than applying anti-dumping measures, has arisen in the debate. Some Members have argued that the maintenance of a dual system (of anti-dumping duties for third parties and competition policy for RTA parties) is likely to have trade distortive effects.¹¹⁸

58. In relation to safeguards under GATT Article XIX, Members have endorsed a wide range of conflicting views:¹¹⁹

- (a) One view is that the application of safeguard measures is *forbidden* in trade among parties to an RTA. For those supporting that view, the list of ORRC exceptions is exhaustive; therefore, RTA parties are not permitted to apply any restrictive measures

¹¹¹ HKC, WT/REG/W/27.

¹¹² Argentina, WT/REG/M/15, para. 32.

¹¹³ Switzerland, WT/REG/M/15, para. 35.

¹¹⁴ HKC, WT/REG/M/15, para. 38.

¹¹⁵ In referring to the need for EIAs to have substantial sectoral coverage, this footnote reads: "This condition is understood in terms of number of sectors, volume of trade affected and modes of supply. In order to meet this condition, agreements should not provide for the *a priori* exclusion of any mode of supply".

¹¹⁶ Issue recorded in WT/REG/W/12, para. 20.

¹¹⁷ Canada, WT/REG/M/15, para. 26.

¹¹⁸ Japan, WT/REG/W/28.

¹¹⁹ Only a few agreements explicitly allow for the exclusion of RTA partners from a global safeguard action; in other agreements, this exemption is implicit.

against each other (especially safeguard measures in any global action) other than those specified in the bracketed list.¹²⁰

A narrow interpretation of the list of exceptions would conform with common practice in cases of derogations from general principles. Footnote 1 to Article 2.1 of the Agreement on Safeguards, which states that "[n]othing in this Agreement prejudices the interpretation of the relationship between Article XIX and paragraph 8 of Article XXIV of GATT 1994", has been cited in support of this argument.

The economic argument offered is that in concluding a customs union or FTA, Members commit themselves to a level of economic integration that goes beyond MFN obligations and seek to achieve efficiencies in their internal markets, thus satisfying Article XXIV:4 which states that the purpose of an RTA is to "facilitate trade".¹²¹ Such efficiencies would be compromised if safeguard measures were used beyond the transition period envisaged in the agreement. Thus, while RTA parties might have recourse to apply safeguard measures against their RTA partners during the transition period of the agreement, they are *required to exempt* RTA partners from any global safeguard action once the FTA or customs union is fully implemented. Furthermore, safeguard actions should no longer be used in intra-trade after the end of the transition period.¹²²

- (b) Some Members are of the view that safeguard measures are to be applied on an MFN basis, i.e. both to the RTA parties and to other WTO Members. If global safeguards are applied, then it is *obligatory* that they also apply to trade among parties to an RTA. The list of exceptions would therefore be purely illustrative.¹²³

In support of this view, several arguments have been put forward. First, the list of exceptions should only be regarded as indicative, given that it does not include GATT Article XXI (Security Exceptions), which no Member would willingly forfeit. Second, the effect of safeguard measures is similar to that of measures under Articles XI and XII, both of which are specified in the exceptions list. Third, selectivity in the application of global safeguards would lead to discrimination towards third parties and compromise the MFN principle contained in Article 2:2 of the Agreement on Safeguards ("[s]afeguard measures shall be applied to a product being imported irrespective of its source"). Finally, from an economic perspective, safeguard measures are only to be used in special circumstances when a Member is experiencing serious injury to a domestic industry; if imports continue to flow from an RTA partner, it is questionable whether the injury is indeed serious enough to justify the safeguard action against third parties.¹²⁴

- (c) Another line of thought is that the application of safeguard measures is *permitted* in trade among parties to an RTA. In this context, it is noted that flexibility should apply in some cases, as supported by the international law on multilateral treaties whereby RTA parties are entitled to vary their rights and obligations between themselves, provided they do so in a manner that does not abridge the rights of third

¹²⁰ Australia, WT/REG/M/15, para. 40.

¹²¹ Canada, WT/REG/M/15, para. 26.

¹²² Australia, WT/REG/W/18, paras. 21-24.

¹²³ Japan, WT/REG/M/14, para. 7; HKC, WT/REG/M/15, para. 22. This reflects a more general concern about the potential erosion of their MFN rights.

¹²⁴ Japan, WT/REG/W/29, paras. 8-11.

parties.¹²⁵ Members supporting that interpretation were however divided on the nature of the ORRC list and the situations justifying such flexibility:

- The case of customs unions
For some Members, since the substitution of a single customs territory for two or more customs territories implies that only a single set of duties and ORCs may be maintained within a customs union, a dual situation could occur whereby some internal safeguard measures would apply specifically to intra-trade, while such trade was exempted from a global safeguard action.¹²⁶ Such a view has been however questioned on the grounds that the requirement to apply global safeguards on an MFN basis continues to hold in the case of customs unions, given paragraph 8(a)(ii) does not require the total harmonization of the external regime.¹²⁷
- *De minimis* conditions
For some other Members, RTA parties are entitled to exempt their partners from global safeguard actions depending on whether the imports from the RTA partner accounts for a "substantial share" of total imports and contributes to "serious injury". Safeguard actions on intra-trade would be permitted only if it was determined that the injury was due to the reduction of duties contemplated in the agreement.¹²⁸
- The case of interim agreements leading to customs unions
It has been argued that parties to a customs union should be entitled to apply internal safeguard measures against each other only during the transition period of an agreement. Once the customs union is fully implemented, the gradual harmonization of competition laws and other relevant legislation would obviate the need for parties to take commercial defence measures against each other.¹²⁹

(ii) *Subparagraph 8(a)(ii)*

59. Subparagraph 8(a)(ii) requires parties to a customs union to apply "substantially the same duties and other regulations of commerce" *vis-à-vis* third parties. The main issue raised in this context is how that requirement should be reflected in the harmonization of the external trade regime of members of a customs union:¹³⁰

- (a) It has been argued that the word "substantially" indicates that total harmonization of the external regime is not required,¹³¹ in particular if that implies a further derogation from the MFN principle or an increase in barriers *vis-à-vis* third countries. If total harmonization is envisaged, then it should be achieved by setting the external regime at the lowest of the individual barriers maintained by parties of a customs union.¹³²

¹²⁵ EC, WT/REG/M/14, para. 13.

¹²⁶ *Ibid.*, para. 9.

¹²⁷ HKC, WT/REG/W/19, para. 11; Korea, WT/REG/M/14, para. 10.

¹²⁸ Israel, WT/REG31/M/1, para. 30; Canada, WT/REG38/M/1, para. 44.

¹²⁹ EC, WT/REG/M/15, para. 44.

¹³⁰ The extension to new parties of a customs union of contingency protection measures and quantitative restrictions already applied by the union and the modification of non-tariff agricultural commitments have emerged as actual controversial issues. Korea, WT/REG3/M/3, para. 70.

¹³¹ Otherwise the requirement would have said "exactly". Japan, WT/REG/M/15, para. 18.

¹³² US, WT/REG/M/15, para. 39.

In the view of some Members, harmonization under Article XXIV cannot be used to justify measures which require an examination of the new situation arising from the creation or enlargement of an RTA, involving both the party (or parties) originally maintaining that measure and the one(s) which hitherto did not maintain that measure. Harmonization on the basis of the most trade-restrictive regime could take place only if the application of the measure by all parties was justified in accordance with WTO provisions.¹³³

It has also been argued that parties to a customs union have no stronger obligation to apply externally the same *restrictive* regulations of commerce than the same *non-restrictive* regulations, since the subparagraph does not make that distinction.¹³⁴

- (b) By contrast, it has been argued that Article XXIV allows customs unions, in the process of substituting a single customs territory for two or more customs territories, to introduce new trade measures that could affect third parties provided the net effect of the new trade regime is not overall worse, as requested by Article XXIV:5.¹³⁵

Further, it has been argued that the harmonization of policies benefits third countries by, *inter alia*, simplifying the legal framework and reducing transaction costs, despite the fact that in some cases it meant that parties to a custom union had to adopt (generally, only during the transition period) trade restrictive measures that were not applied previously.¹³⁶

In this context, it has also been noted that, throughout the years, the direction taken by both European integration and multilateral rule-making in trade matters has had an impact on the definition of customs unions, with the result that the application of common commercial and competition policies by all its parties has become an essential element in its proper functioning.¹³⁷ This argument was contested on the grounds that such reasoning had not been applied across the board.¹³⁸

60. In the *Turkey-Textiles* case, the Panel found that the flexibility provided for in sub-paragraph 8(a) by the existence of the word "substantially" meant that "... a situation where constituent members have "comparable" trade regulations having similar effects with respect to the trade with third countries, would generally meet the qualitative dimension of the requirements of sub-paragraph 8(a)(ii)" and that Members are allowed to form a customs union "... where one constituent member is entitled to impose quantitative restrictions under a special transitional regime and the other constituent member is not."¹³⁹ While agreeing with the statement by the Panel that the phrase "substantially the same" in sub-paragraph 8(a)(ii) offered a certain degree of flexibility to the constituent members of a customs union in the creation of a common commercial policy, the Appellate Body disagreed with the Panel in that the limits established by such flexibility meant that "comparable" trade regulations having similar effects with respect to the trade with third countries would meet the standard of sub-paragraph 8(a)(ii). Rather, it concluded that a higher degree of "sameness" was required.¹⁴⁰

61. The fact that some customs unions do not have all of their commercial policy instruments harmonized has attracted two types of reaction:

¹³³ Korea, WT/REG/M/14, para. 10; HKC, WT/REG/M/15, para. 38.

¹³⁴ HKC, WT/REG/W/19, para. 10.

¹³⁵ EC, WT/REG22/M/2, para. 21.

¹³⁶ Turkey, WT/REG22/M/1, para. 8.

¹³⁷ *Ibid.*, para. 7.

¹³⁸ US, WT/REG22/M/1, para. 13.

¹³⁹ WT/DS34/R, para. 9.151.

¹⁴⁰ WT/DS34/AB/R, paras. 49-50.

- (a) On one line, it has been said that it appears that harmonization has taken place only where it benefited parties to customs unions and disadvantaged third parties, and that even in cases where such harmonization is foreseen in the future, the test of Article XXIV:8 was not met.¹⁴¹
- (b) Alternatively, it has been argued that it was natural for the process of economic integration and harmonization to proceed faster in some areas than in others,¹⁴² but that differences in the regimes applied only for the transition period and that the commitment by the parties to harmonization would suffice to meet Article XXIV:8 requirements.¹⁴³

2. Article XXIV:5 and corresponding paragraphs of the 1994 Understanding

62. Some of the issues raised with respect to Article XXIV:5 provisions have already been dealt with in earlier parts of this document.¹⁴⁴ On two other issues, common to both subparagraphs 5(a) and 5(b), Members have also offered various views:

- (a) Definition or coverage of ORCs

It has been said that the term "ORCs" has an "outward-looking" meaning and refers to those regulations governing the trade of the parties to an RTA with non-parties, in particular when the regulations become more restrictive.¹⁴⁵ That, it is asserted, is supported by the fact that ORCs are referred to in both paragraph 5(a) and subparagraph 8(a)(ii), which deal with customs unions' trade relations with third parties.

It has also been noted that, in the GATT years, a wider but yet more neutral definition of the term had been once advanced, according to which the word "regulations" might be related to such measures as customs procedures, grading and marketing requirements, and similar controls in international trade.¹⁴⁶

Defendants of a broader interpretation have made reference to the drafting history of the 1994 Understanding and stated that ORCs relate to all formalities in connection with importation and exportation, including those not intended to be restrictive. From an economic point of view, they have noted that the facilitation of intra-trade requires RTA parties to deal with a wide range of ORCs; also, the alignment of the parties' external trade policies is needed to establish conditions of fair competition among them and to allow a customs union to function properly.¹⁴⁷

Another proposal is to consider whether the language of paragraph 2(c) of the Enabling Clause, when referring to the possibility of reducing or eliminating on a mutual basis non-tariff measures applied on trade between developing countries, is pertinent to the discussion.¹⁴⁸

¹⁴¹ US, WT/REG22/M/2, para. 12.

¹⁴² The pace would depend on the issue, exercise, legislative framework and economic significance of the measures being considered.

¹⁴³ EC, WT/REG22/M/2, para. 23.

¹⁴⁴ See Section C.1(ii).

¹⁴⁵ Canada, WT/REG/M/15, para. 26.

¹⁴⁶ EC, WT/REG/M/14, para. 9, referring to a statement recorded in the Report on the examination of the Treaty of Rome, BISD 6S/78, para.5.

¹⁴⁷ Turkey, WT/REG/M/16, para. 54.

¹⁴⁸ Switzerland, WT/REG/M/14, para. 15

In the *Turkey-Textiles* case, the Panel stated that "... it is clear that this concept includes quantitative restrictions. More broadly, the ordinary meaning of the terms "other regulations of commerce" could be understood to include any regulation having an impact on trade (such as measures in the fields covered by WTO rules, e.g. sanitary and phytosanitary, customs valuation, anti-dumping, technical barriers to trade; as well as any other trade-related domestic regulation, e.g. environmental standards, export credit schemes). Given the dynamic nature of regional trade agreements, we consider that this is an evolving concept."¹⁴⁹

(b) Scope of the requirement that ORCs should not become more restrictive

It has been noted that, in assessing the restrictiveness of ORCs before and after the formation of an RTA, there might be a need to distinguish cases where the agreement merely contains a provision permitting the parties to introduce a certain type of ORC measures and cases of actual application of such measures (e.g., the introduction of anti-dumping legislation and the actual use of anti-dumping measures might be treated differently, as it was not possible to predict whether the new legislation would actually be used).¹⁵⁰

(i) *Subparagraph 5(a) and paragraph 2 of the 1994 Understanding*

63. Subparagraph 5(a) provides that, in the case of a customs union (or an interim agreement leading to a customs union), the MFN "duties and other regulations of commerce imposed" at its institution "shall not on the whole be higher or more restrictive than the general incidence of the duties and other regulations of commerce applicable" by Members parties to such customs union prior to its formation. According to the 1994 Understanding, the assessment of their incidence may involve "the examination of individual measures, regulations, products covered and trade flows affected".

64. One issue which has attracted attention refers to the assessment of the effects of duties and ORCs - is there a single, broad requirement for duties and ORCs grouped together or do duties and ORCs have to comply individually with the requirement?

- (a) Some Members maintain that these are two separate requirements, with compliance required for each. For them, a key word is the "or" in the phrase "shall not on the whole be higher or more restrictive...", where duties could not be "higher" and ORCs could not become "more restrictive".¹⁵¹ Further, in addressing the evaluation under Article XXIV:5(a), the 1994 Understanding refers to two overall assessments - i.e. that of tariffs, and that of ORCs which are difficult to quantify and aggregate.¹⁵²
- (b) Other Members argue that the appearance of the words "on the whole" in Article XXIV:5(a) indicates that there is only one assessment, with tariffs and ORCs being lumped together; implying that certain benefits involved in one particular element might offset certain deficiencies in the other.¹⁵³ That interpretation has been questioned on the grounds that Article XXIV:5(b), which refers to FTAs, does not contain the term "on the whole".¹⁵⁴

¹⁴⁹ WT/DS34/R, para. 9.120.

¹⁵⁰ See Australia, WT/REG/W/25, para. 9; Japan and HKC, WT/REG/M/17, paras. 13-14, respectively.

¹⁵¹ HKC, WT/REG/M/15, para. 22; Japan, WT/REG/M/16, para. 59.

¹⁵² HKC, WT/REG/M/16, para. 57.

¹⁵³ EC, WT/REG/M/16, para. 63.

¹⁵⁴ *Supra*, footnote 152.

65. Some findings of the Panel in the *Turkey-Textiles* case, spelled out in paragraph 37 above, may also shed light on this issue.

(ii) *Subparagraph 5(b)*

66. Subparagraph 5(b) requires that, in the case of FTAs (or relevant interim agreements), the MFN "duties and other regulations of commerce maintained in each of the territories" and "applicable at the formation" of the FTA ("or the adoption of such interim agreement") are not to "be higher or more restrictive than the corresponding duties and other regulations of commerce existing ... prior to the formation of the free-trade area ...".

67. Many of the questions raised in this context have already been recorded in some detail in earlier sections of this paper. A few other topics are relevant to that subparagraph:

(a) Examination of FTAs involving at least one country in the process of accession to the WTO^{155,156}

At issue was whether the existence of such FTAs would have a direct impact on the results of the accession negotiations. To the opinion that the existence of an FTA would not affect the outcome of such negotiations,¹⁵⁷ others were of the view that the basis for the accessions negotiations would be altered.¹⁵⁸

Another point raised was whether assessing the compatibility of such FTAs with Article XXIV:5(b) would at all be possible, in a situation of moving targets derived from the accession negotiations and of the absence of markers in the form of WTO legal commitments for the non-Members parties to the FTA. It was noted that such an assessment could only be made when the extent of the preferences exchanged among the parties were measurable, i.e. only once the accession negotiations were completed.¹⁵⁹

(b) Comparison of the duties and ORCs applicable at the formation of a new FTA with those of a pre-existing FTA with overlapping membership¹⁶⁰

It has been argued that, where a prior FTA existed, paragraph 5(b) requirements could mean that the proper basis for comparison would include that prior FTA, as the words "same constituent territories" are not qualified by an assumption that there had been no other previous preferential arrangement involving the same parties and "prior" does not assume MFN treatment.¹⁶¹

An opposing view has been that a pre-existing FTA is a separate agreement and could therefore not be the basis for comparison.¹⁶²

¹⁵⁵ Issue recorded in WT/REG/W/16, paras. 53-54.

¹⁵⁶ The more general issue regarding the formation of an FTA where a party is not a Member and hence does not have MFN rates (neither bound nor applied) has not yet been thoroughly debated.

¹⁵⁷ EC, WT/REG1-2,7-9/M/1, paras. 57 and 66.

¹⁵⁸ Canada, WT/REG1-2,7-9/M/1, paras. 11, 56, 61.

¹⁵⁹ *Ibid.*

¹⁶⁰ Korea, WT/REG/M/4, para. 64.

¹⁶¹ EC, WT/REG4/M/2, para. 38. Issue recorded in para. 22 of WT/REG/W/16 and para. 6 of WT/REG/W/12.

¹⁶² NAFTA Parties, WT/REG4/M/2, para. 34.

(c) Non-zero preferential tariff rates

Some Members have argued that applying preferential rates in the context of an FTA, lower than the MFN rate but higher than zero, means raising barriers to trade to third parties, a concept covered in paragraph 5(b).¹⁶³

Other Members have asserted that such rates should be assessed in the context of paragraph 8 and that the obligation not to raise barriers to third parties under paragraph 5(b) is not relevant in such a case.¹⁶⁴

3. Article XXIV:6 and paragraph 4 of the 1994 Understanding

68. Paragraph 6 states that if, during the course of forming a customs union, "a contracting party proposes to increase any rate of duty inconsistently with the provisions of Article II, the procedure set forth in Article XXVIII shall apply". Paragraph 4 of the 1994 Understanding clarifies that this procedure "must be commenced before tariff concessions are modified or withdrawn upon the formation of a customs union or an interim agreement leading to the formation of a customs union".

69. The main underlying issue refers to the timing of renegotiations for breach of bindings.¹⁶⁵

(a) In cases where the adoption of a common external tariff by parties to a customs union takes place in large measure without a transition period, some Members have stated the difficulty of beginning such renegotiations before the withdrawal of tariff concessions, i.e. before concluding the negotiations for the formation of the customs union itself.

(b) Other Members consider, however, that a withdrawal of concessions before the initiation of negotiations under paragraph 6 is inconsistent with the provisions of GATT 1994.¹⁶⁶ Their suggestion that the spirit of Article XXIV would support a practice of reaching substantial progress in compensatory negotiations before tariff concessions were withdrawn¹⁶⁷ has been rejected by other Members on the grounds that where customs unions are criticised for having long transition periods, such a procedural norm might have the effect of further prolonging transition periods.¹⁶⁸

E. INTERPRETATION OF CONCEPTS AND PROVISIONS CONTAINED IN GATS ARTICLE V

1. Article V:1

(i) *Subparagraph 1(a)*

70. Article V:1(a) provides that an EIA must have "substantial sectoral coverage" of the trade in services among the Parties. The footnote to the provision states that "substantial sectoral coverage" should be "understood in terms of number of sectors, volume of trade affected and modes of supply". The footnote also provides that an EIA may not "*a priori*" exclude any of the four modes of supply.

71. Although the parameters to be examined in order to determine conformity between an EIA and Article V have been identified, the question has been asked as to whether these are limited to the parameters listed in the footnote or if there are other considerations. Moreover, there are differing

¹⁶³ US, WT/REG11/M/2, para. 10.

¹⁶⁴ EC, WT/REG11/M/2, para. 14.

¹⁶⁵ Issue recorded in WT/REG/W/12, para. 5(a).

¹⁶⁶ Japan, WT/COMTD/1/Add. 9, para. 45.

¹⁶⁷ Korea, WT/REG3/M/3, para. 10.

¹⁶⁸ EC, WT/REG22/M/2, para. 15.

views over the extent to which liberalization must take place within these parameters in order for an EIA to meet the "substantial sectoral coverage" test.¹⁶⁹

72. Members hold differing views on the scope of the "substantial sectoral coverage" criterion, in particular on whether one or more sectors can be excluded from an EIA:

- (a) It is argued that the use of the wording "numbers of sectors" in the footnote to paragraph 1(a) supports the view that not all sectors must be covered under an EIA to meet the "substantial sectoral coverage" test; otherwise the text would have clarified that all (as opposed to a "number of") sectors had to be covered.¹⁷⁰ However, differing views exist regarding the extent of such exclusions:
 - some Members have indicated that the number of exclusions would have to be restricted and not further limited by the volume of trade affected and the modes of supply.¹⁷¹
 - other Members have argued that *a priori* exclusions of sectors covered and volume of trade affected are permissible, given that the footnote to Article V:1(a) specifies that no mode of supply can be *a priori* excluded but the same requirement is not extended to sectors or volumes of trade.¹⁷²
- (b) A differing perspective is that the flexibility provided by the word "substantial" does not allow for the exclusion of a sector from an EIA. A less unequivocal view in this context is that "essential" services (those which serve as infrastructure for economic activity, such as transportation) may not be excluded from coverage by an EIA.¹⁷³ Furthermore, the exclusion of major service sectors would need to be considered in conjunction with the modes of supply and the volume of trade involved.¹⁷⁴

73. Also, on the coverage of modes of supply, it has been argued that an EIA must include all modes of supply in order to comply with subparagraph 1(a) requirements; in particular, no EIA should *a priori* exclude investment and labour mobility in the sense of Modes 3 and 4. For some delegations, certain Mode 4 aspects exempted from the GATS through the *Annex on the Movement of Natural Persons* had to be included in an EIA for the agreement to be consistent with the GATS.¹⁷⁵

74. Still in this context, the degree of detail of the examination, i.e. whether it should take place on a sector-by-sector, subsector-by-subsector or on a completely disaggregated basis, has been briefly addressed. Some Members have favoured examination on a sector-by-sector basis, given the lack of detailed data on services trade and the fact that footnote 1 to subparagraph 1(a) lists the number of sectors covered by an EIA as one of the three separate factors to be examined in evaluating sectoral coverage.¹⁷⁶ Some other related questions raised, but not discussed, are as follows:¹⁷⁷

- How can it be determined whether all sectors have been covered or not?

¹⁶⁹ This issue is parallel to the discussions over the relative merits of a quantitative vs. a qualitative test for the SAT requirement under Article XXIV.

¹⁷⁰ EC, WT/REG50-52/M/2, para. 16; New Zealand, WT/REG/M/22, para. 17.

¹⁷¹ New Zealand, WT/REG/M/22, para. 17.

¹⁷² EC, WT/REG/W/35, para. 4.

¹⁷³ Japan and Korea, WT/REG/M/22, paras. 18 and 20, respectively.

¹⁷⁴ Argentina, WT/REG/M/22, para. 16.

¹⁷⁵ Japan, WT/REG/M/22, para. 18.

¹⁷⁶ HKC, Section 3 of the non-paper referred to in footnote 101; HKC and India, WT/REG/M/23, paras. 7 and 12, respectively.

¹⁷⁷ HKC, Section 3 of the non-paper referred to in footnote 101.

- How is the volume of trade affected to be calculated where a sector is less than fully liberalized?¹⁷⁸ Would it make sense to include in the calculation only that portion of trade in a sector that has been completely liberalized by the provisions of the EIA?
- If the setting of a percentage target could be feasible for examining the coverage of an EIA, what would be more appropriate: a percentage target for the volume of services trade covered or for the volume of domestic services activity covered?
- How would the "absence or elimination of substantially all discrimination" and the list of excepted measures under Article V:1(b) affect the percentage targets that might be set?

75. The unavailability of reliable data on trade in services has been an issue raised in this context. It has been suggested that given the difficulty in obtaining statistics on the volume of services trade, data on domestic economic activities could be used instead.¹⁷⁹ Statistics on the size of the domestic market of services sectors concerned or their contribution to GDP could help determine the coverage of sectors, based on the assumption that a sector representing more than a certain proportion of GDP was bound to be significantly traded within an EIA.¹⁸⁰ Another argument advanced in favour of using data on domestic services activity covered by an EIA is that sectors excluded from trade by domestic regulations would be underrepresented in services trade data, and indeed might not show any trade volume at all. Moreover, percentage breakdowns of domestic services activity were more likely to be consistent across countries than trade data.¹⁸¹

76. Other questions raised in the context of subparagraph 1(a) include:

- Should the parameters in the footnote be viewed as providing a basis for assigning weights to the sectors covered by the liberalization provisions, or as establishing three separate factors to be considered in making an overall judgement? Are the factors exhaustive?¹⁸²
- Can the exclusion of services supplied in the exercise of governmental authority, as provided for in GATS Article I:3(b), be extended to the scope of the EIA?
- Does a requirement that foreign suppliers establish themselves in local jurisdiction before they be allowed to sell services to local consumers amount to an *a priori* exclusion of cross-border trade in these services? Should this be regarded as a violation of footnote 1 to Article V:1(a) even where individual sub-national governments impose an establishment requirement for inter-state trade within that country?¹⁸³
- Can an EIA exclude all or substantial portions of the Transport sector, which is substantially carved out of the GATS disciplines at this stage by virtue of the *Annex on Air Transport Services* and as a result of the failure to conclude the negotiations on Maritime Transport Services? Would it be reasonable to assume that an EIA should meet a higher standard than is contained in the GATS, and therefore that an EIA should provide for the integration of the whole transport services sector among the parties of the EIA? What would be the rationale for an *a priori* exclusion of transport services?¹⁸⁴

¹⁷⁸ Given the insufficiency of statistics in the services area, the EC have argued that it is pointless to pursue the idea of percentages of sectors/trade excluded, but that, nonetheless, an attempt should be made to define the volume of trade affected (WT/REG/W/35, para 6).

¹⁷⁹ Japan and HKC, WT/REG/M/22, paras. 18 and 27, respectively.

¹⁸⁰ Korea, WT/REG/M/22, para. 20.

¹⁸¹ *Supra*, footnote 177.

¹⁸² HKC, WT/REG/W/34, para. 6.

¹⁸³ *Supra*, footnote 177.

¹⁸⁴ *Ibid.*

(ii) *Subparagraph 1(b)*

77. Subparagraph 1(b) requires that an EIA should provide for "the absence or elimination of substantially all discrimination in the sense of Article XVII" through (i) elimination of existing discriminatory measures, and/or (ii) prohibition of new or more discriminatory measures, with certain listed exceptions. The provisions under this clause should be implemented either at the entry into force of the Agreement or on the basis of "a reasonable time-frame".

78. The chief issue here centres around the meaning of "substantially all discrimination", in terms of the extent to which discriminatory measures should be allowed to exist in an EIA without breaching its consistency with Article V:I(b).¹⁸⁵ The scope of such permissible discriminatory measures after entry into force of the agreement would be directly influenced by a definition of the scope of the list of exceptions in Article V:1(b) as well as the applicability of the "and/or" language in the context of provisions (i) and (ii).

79. With respect to the scope of the list of exceptions, several Members have argued that the list is not exhaustive.¹⁸⁶ Expansion of the list of exceptions has been considered permissible on the basis of the Preamble of the GATS, which refers to "the rights of Members to regulate, and to introduce new regulations, on the supply of services within their territories in order to meet national policy objectives"; however, what is covered in the national treatment clause should not be added to the list.¹⁸⁷

80. In regard to the application of emergency safeguards among the parties to an EIA, divergent views have been expressed:

- (a) it has been suggested that Article X be added to the listed exceptions so that safeguard measures can be applied on a MFN basis to parties to a EIA and third countries alike and thus be in line with the principle provided for in Article X:1, i.e. that safeguard measures have to be based on the principle of non-discrimination;¹⁸⁸ and
- (b) safeguard measures should not be applied among EIA parties, as they act against comparative advantage, which is in fact a very important benefit of integration agreements.¹⁸⁹

81. Additional questions have arisen in this context:

- What types of discriminatory measures, besides those that fall under the enumerated Articles of the GATS, should be considered as legitimate exceptions from the requirement in Article V:1(b) for the "absence or elimination of substantially all discrimination"?¹⁹⁰
- How should the requirements of Article V:1(b) be interpreted in view of the further negotiations contemplated under Articles VII, X, XIII, XV, and the various annexes to the GATS?¹⁹¹

¹⁸⁵ Japan suggested that the meaning of the term "substantially all" in GATT Article XXIV:8 might provide a hint as to the same term meant in GATS Article V:1(b) (WT/REG/M/22, para. 18).

¹⁸⁶ Argentina, Japan and Korea, WT/REG/M/22, paras. 16, 18 and 20, respectively.

¹⁸⁷ Japan, WT/REG/M/22, para. 18.

¹⁸⁸ Korea, WT/REG/M/22, para. 20.

¹⁸⁹ Australia, WT/REG39/M/2, para. 11.

¹⁹⁰ HKC, Section 2 of the non-paper referred to in footnote 101.

¹⁹¹ HKC, WT/REG/W/34, para. 9.

- Do all existing EIAs meet the test of Article V:1(b) that all forms of discrimination with respect to the regulation of professional services, air transportation services and financial services are eliminated? Do they all provide for the elimination of all forms of discrimination in government procurement of services or in the provision of subsidies to services suppliers?¹⁹²

82. The interpretation of the "and/or" wording in subparagraph 1(b) has also attracted Members' attention:

- (a) One view has been that the "or" allows the parties to the agreement to choose between provisions (i) and (ii), that is, the elimination of existing discriminatory measures, or alternatively, the use of a standstill. A party could therefore choose only to eliminate the possibility of adding new measures or of making existing measures more restrictive, rather than also have to eliminate existing measures.¹⁹³
- (b) Others have subscribed to the view that rather than providing a choice between (i) and (ii), the purpose of the wording is to offer flexibility in applying this provision according to the status of discriminatory measures in the sector under consideration.¹⁹⁴ In cases where no discrimination exists at the time of entry into force of the agreement or where remaining discriminatory measures do not exceed the level required to satisfy the "substantially-all-discrimination" requirement, only (ii) would apply. In cases where such discrimination remains beyond the level of requirement of this Article at the time of entry into force of the agreement, (i) would be naturally applicable to eliminate substantially all discrimination. In this case, one could argue that the applicability of (ii) depends on the extent to which the discriminatory measures are eliminated by (i).
- (c) However, considering that Article V:1(b) aims to deal with "substantially all discrimination" in the sense of Article XVII on national treatment, it has been suggested that it would be appropriate to interpret that both (i) and (ii) are applicable.¹⁹⁵ Thus, it is argued that paragraphs (i) and (ii) are options to be judged as appropriate against the circumstances of the sector being considered, not as alternatives to be freely chosen by the parties to the agreement. It has therefore been considered important to look at the paragraph containing (i) and (ii) *as a whole*.

83. Some Members have emphasized the need to view the "and/or" provision in conjunction with the objective underlined in the chapeau of paragraph V:1(b), which provides that "the absence or elimination" of substantially all discrimination be exercised in the sense of Article XVII of the GATS.¹⁹⁶ The reference to Article XVII would pre-empt interpreting Article V as a simple standstill agreement, particularly through the "absence or elimination" wording, which entails both the elimination of discriminatory measures where they exist and a commitment not to introduce new ones. A requirement to eliminate new or more discriminatory measures, by itself, would not achieve the end result of dealing with substantially all discrimination in the sense of national treatment.¹⁹⁷

¹⁹² *Ibid.*

¹⁹³ US, WT/REG4/M/4, para. 21.

¹⁹⁴ EC, WT/REG4/M/4, para. 19 and WT/REG/W/35, para. 8; Japan, non-paper entitled *Interpretative Remarks on Article V.1 of GATS*, para. 3.B.

¹⁹⁵ Japan, non-paper referred to in footnote 194, para. 3.C.

¹⁹⁶ EC, WT/REG4/M/4, para. 19.

¹⁹⁷ *Ibid.*, para. 22.

84. Other topics discussed in relation to subparagraph 1(b) were as follows:

- (a) Given the lack of detailed data on trade in services, Members have articulated the difficulty in arriving at a percentage-type test for quantitatively measuring "substantially all discrimination", similar to the one used in defining "substantially all the trade" in the context of Article XXIV. It would follow therefore, that each agreement be examined on its own merit.¹⁹⁸
- (b) On the definition of the "reasonable time-frame" provision, it has been proposed that a ten-year limit be used as a general starting-point for defining the "reasonable time-frame" provision, based on a similar provision in GATT Article XXIV:5(c) and paragraph 3 of the Understanding on the Interpretation of Article XXIV of GATT 1994.¹⁹⁹

Other Members considered a ten-year period as being too long.²⁰⁰ They consider a five year period more appropriate, given that the next round of negotiations of trade in services was scheduled to commence five years after the entry into force of the GATS.²⁰¹ It has been questioned whether the extension of certain key GATS obligations such as national treatment, gradually and only to certain selected sectors over time by an EIA, could be regarded as being in breach of both Articles V and XVII in terms of pace and coverage.²⁰²

Another view has considered that a "reasonable time-frame" should be applied to agreements on a case-by-case basis rather than being formally defined; for instance, under circumstances of harmonization and fuller integration within an EIA, a ten year period would be appropriate.²⁰³

2. Article V:2

85. Paragraph 2 states that the evaluation of an agreement's consistency with Article V:1(b) may also take into account its relationship to "a wider process of economic integration or trade liberalization" among the parties to the agreement. This has raised two issues, namely:

- (a) Interpretation of "a wider process of economic integration"
It has been said that "wider process of economic integration" could be construed as one involving the elimination of barriers to trade not only in services but also in goods; the drafting history of this paragraph supports such an argument. The harmonization of government regulation measures among parties to an EIA could also contribute to such a process.²⁰⁴
- (b) Relationship of an EIA's compliance with Article V to a wider process of economic integration
Identifying the implications of "a wider process of economic integration" for examining the consistency of an EIA with Article V has been perceived as influencing the discussions on the interpretation of "substantially all the trade" and

¹⁹⁸ New Zealand, WT/REG/M/22, para. 17.

¹⁹⁹ Australia, WT/REG/M/22, para. 15.

²⁰⁰ US and Japan, WT/REG50-52/M/2, paras. 5 and 6, respectively.

²⁰¹ Japan, WT/REG/M/22, para. 18.

²⁰² Canada, WT/REG50-52/M/2, para. 13.

²⁰³ EC, WT/REG50-52/M/2, para. 9.

²⁰⁴ WT/REG/W/34, para. 11; Japan, WT/REG/M/23, para. 31; EC, WT/REG/W/35, para. 11.

that of a "reasonable time frame".²⁰⁵ One interpretation offers that the existence of such a process could lower threshold levels for the allowance of discriminatory measures that continue to exist among parties to an EIA.²⁰⁶

86. A "wider process of economic integration" refers specifically to the lowering of intra-trade barriers within an EIA; the extent to which this process could affect the "overall level of barriers" to the trade of third parties is addressed below under Article V:4.

3. Article V:3

87. Subparagraph V:3(a) allows "flexibility" to the parties of an EIA that involves developing country Members, in meeting the conditions of paragraph 1 (particularly with respect to subparagraph (b)). This flexibility is to be granted "in accordance with the level of development of the countries concerned, both overall and in individual sectors and subsectors".

88. The primary concern here is whether the margin of flexibility granted to developing countries should be defined and, if so, how. Other questions have been raised within this context, which have not yet been discussed:²⁰⁷

- Would flexibility be granted in complying with the requirement of eliminating "substantially all discrimination" as well as in that of implementing such elimination within a "reasonable time frame"?
- Does a specific reference to subparagraph (b) of Article V:1 imply that relatively limited flexibility will be provided in meeting the conditions of "substantial sectoral coverage" as provided for in Article V:1(a)? If so, how might that flexibility be set out?
- In the case of an EIA comprising both developed and developing country members, would Article V:3(a) extend "flexibility" to the services regimes of countries other than developing countries "in accordance with the level of development of the countries concerned"?

89. Subparagraph 3(b) states that notwithstanding paragraph 6, in the case of an EIA involving only developing countries, "more favourable treatment may be granted to juridical persons owned or controlled by natural persons of the parties to such an agreement."

90. In relation to the extent of favourable treatment that could be granted to companies owned by citizens of such an EIA, questions raised included the following:

- (a) Whether granting more favourable treatment in the sense of this provision should occur within the limits circumscribed by Article V:4, so as to not raise the "overall level of barriers" in each sector and subsector above previous levels.²⁰⁸
- (b) Whether it would be possible to define the degree of favourable treatment by establishing some limits or conditions for granting such treatment, such as, for example, by reserving more favourable treatment to enterprises that are not globally competitive.²⁰⁹

²⁰⁵ Korea, WT/REG/M/21, para. 20.

²⁰⁶ HKC, WT/REG/W/34, para. 11.

²⁰⁷ *Ibid.*, para. 12.

²⁰⁸ *Ibid.*, para. 14.

²⁰⁹ *Ibid.*

91. In this context, it has also been noted that favourable treatment as under Article V:3(b) should be interpreted in conjunction with the purpose of Article V:3(a) which is to consider the situation of developing countries that have a lower competitiveness in trade in services.²¹⁰

4. Article V:4

92. Paragraph 4 stipulates that parties to an EIA must ensure that the agreement does not "raise the overall level of barriers" to trade in services with respect to third parties "within the respective sectors or subsectors compared to the level applicable prior to such an agreement".

93. Identifying the appropriate method for determining the change in the "overall barriers to trade" in services against third parties remains the primary concern with regard to this provision. Differences in regulatory mechanisms across countries and the absence of detailed data on services significantly impede evaluation of the level of barriers in effect before the establishment of an EIA. It has been observed that although, in theory, all barriers could be converted into tariff equivalents in order to arrive at an average tariff for the parties to an EIA, in practice, such an exercise would encounter significant data and methodological problems. Another approach would be to require that an EIA did not reduce either the level, or growth, of trade in any sector or subsector below a historical trend.²¹¹ Changes in the volume of trade could be judged by data on domestic economic activities if data on trade in services is unavailable.²¹² Another view proposes utilising data from sources such as balance of payments, stocks of foreign direct investment and domestic industries in individual Members for purposes of evaluating the level of barriers.²¹³

94. The discussion on how greater economic integration among parties to an EIA could impact third party trade has drawn attention to one particular situation, i.e. the extension of MFN exemptions by a customs union to its area of enlargement. More specifically, this situation raises three different questions, namely how to classify such exemptions, how to deal with their trade effects, and the legal procedures involved.

95. Regarding classification, some Members have indicated that the extension of MFN exemptions to an enlarged customs union should not be viewed as creating new exemptions but rather as the same exemptions applying to a larger geographical area; for them, the geographic scope of a measure may change following an EIA.²¹⁴ Opposing that view, some other Members thought that such an extension of MFN exemptions qualified as a new measure.²¹⁵ In support, it has been pointed out that such extensions created exemptions of an entirely different character to the original ones²¹⁶ and that acceding parties to an EIA remain Members of the WTO in their own right so that any changes to their schedules would count as a new measure.²¹⁷ The classification of such measures as "new" or, alternatively, "unchanged" MFN exemptions would affect the legal procedures involved, as described in paragraph 100 below.

²¹⁰ Japan, para. 14 of the non-paper referred to in footnote 31.

²¹¹ HKC, WT/REG/W/34, para. 13.

²¹² Japan and HKC, WT/REG/M/22, paras. 18 and 27, respectively.

²¹³ Japan, para. 13 of the non-paper referred to in footnote 31.

²¹⁴ EC, WT/REG3/2/Add.3, reply to question 2(a) and WT/REG3/M/4, para. 18.

²¹⁵ US, WT/REG3/M/4, para. 19 and New Zealand, WT/REG3/M/5, para. 19.

²¹⁶ New Zealand, WT/REG3/M/7, para. 10.

²¹⁷ Korea, WT/REG3/M/5, para. 20.

96. Regarding the trade effects of such extensions of MFN exemptions, divergent views have been expressed on how these should be regarded under the requirements of Article V:4.²¹⁸

- (a) One view was that it was irrelevant to address the question of whether overall barriers to trade had been raised as a result of the extensions in MFN exemptions as they needed to be dealt with under different legal provisions.²¹⁹
- (b) For some Members, it was first necessary to judge whether these measures raised barriers. If that was the case, the situation would have to be evaluated in its totality, namely the negative effects of extended MFN exemptions would have to be balanced with the trade facilitation brought to all WTO Members by the enlargement of a customs union in terms of a larger market and a single regulatory regime.²²⁰
- (c) Some other Members also pointed out the relevance of such an examination for individual sectors, since Article V:4 also refers to an assessment of the effects "within the respective sectors and subsectors".²²¹

97. Other questions yet to be discussed with regard to this provision are the following:²²²

- Under what circumstances can an EIA entail changes to the level of barriers to trade in services with Members outside the EIA?
- Are these changes related to some forms of harmonization/alignment among members to the EIA as to their respective treatments of third parties, in a way similar to that envisaged in the external trade regime of customs unions for goods?
- Does this relate also to the concept of a "wider process of economic integration"?
- What does the existence of "a wider process of economic integration" imply for the "overall level of barriers" against third parties?

5. Article V:5

98. Paragraph 5 requires a party to an EIA to provide at least 90 days advance notice of any modification or withdrawal of a specific commitment that was inconsistent with the terms and conditions set out in its Schedule and stipulates that "the procedure set forth in paragraphs 2, 3 and 4 of Article XXI shall apply".

99. Though Article V:5 relates to compensation to third parties only in the context of specific commitments, divergent views have been expressed concerning the possibility of providing compensation for the extension of MFN exemptions by a customs union to its area of enlargement under this provision:

- (a) For some Members, such extended MFN exemptions qualify as "new" measures; therefore, the relevant legal provision is that of GATS Annex on Article II Exemption and the WTO waiver provisions. For them, MFN exemptions and specific

²¹⁸ HKC, WT/REG3/M/5, para. 17; New Zealand, WT/REG3/M/5, para. 19.

²¹⁹ Australia, WT/REG3/M/7, para. 12.

²²⁰ EC, WT/REG3/M/4, para. 21, WT/REG3/M/7, para. 4, WT/REG3/M/8, para. 3.

²²¹ US, WT/REG3/M/3, para. 19; Japan, WT/REG3/M/4, para. 46; Australia, WT/REG3/M/4, para. 27.

²²² HKC, WT/REG/W/34, para. 13; EC, WT/REG/W/35, para. 12.

commitments were completely different issues and the legal provisions dealing with the latter could not be used for modifications in the former.²²³

- (b) A differing perspective suggests that the automatic extension of MFN exemptions implies that third countries would not benefit from the same access to the acceding parties. This could be assimilated to the fact that commitments taken by those countries are modified or withdrawn, so that compensation according to the Article XXI route, as provided for in Article V:5, would be applicable.²²⁴

6. Article V:6

100. Paragraph 6 provides that a third-party service supplier, legally recognised as a juridical person by a party to an EIA, is entitled to equivalent treatment granted within the EIA, provided that it engages in "substantive business operations" in the territory of the parties to that agreement.

101. The primary issue discussed in relation to this provision has related to the definition of the scope of "substantive business operations" in a way that would not undermine the entitlement of third party suppliers to the same benefits as those of the Parties. The term "business operations" has been considered to cover production, distribution, marketing, sale and delivery of a service, as provided for in Article XXVIII:(b).²²⁵ It has been debated whether third-party suppliers that establish a branch instead of a head office are entitled to equivalent treatment within the EIA. Moreover, apart from having to recruit the majority of board members and shareholders from the concerned party to the EIA, are third-party suppliers also required to trade with the parties to the EIA in order to receive equivalent benefits? One suggestion is that Article V:6 intends to prevent equivalent treatment from being granted to non-established firms or firms which do not participate substantively in commercial transactions.²²⁶

102. Another issue discussed in this connection has been the relationship between national jurisprudence and the GATS. The view has been expressed that provisions under an EIA that had been drafted prior to the GATS would need to be updated in accordance with the GATS.²²⁷ Such an amendment could be viewed as required particularly in the case where national jurisprudence conflicted with GATS rules, or under consideration of potential conflict if GATS rules were to undergo modification in the future.

103. Other questions have been raised with regard to this provision which are yet to be discussed:²²⁸

- Is the term "substantive business operations" meant to distinguish a service supplier *producing* services from one *selling* services?
- Or is it meant to distinguish between a service supplier *actively* producing and/or selling services from one which is merely *legally established* but without as yet any production and sales activities?
- Or is it intended to distinguish between service suppliers who may be "*carrying on*" a service (without being formally established) from those who are *properly legally established*?

²²³ US, WT/REG3/M/5, para. 25; Canada, WT/REG3/M/7, para. 8; Japan, WT/REG3/M/8, para. 5; New Zealand, WT/REG/M/22, para. 17.

²²⁴ EC, WT/REG3/M/7, paras. 3, 4 and 14; Korea, WT/REG3/M/7, paras. 8 and 11.

²²⁵ Japan, para. 15 of the non-paper referred to in footnote 31.

²²⁶ Argentina, WT/REG/M/22, para. 16.

²²⁷ US, WT/REG50-52/M/2, para. 24.

²²⁸ HKC, WT/REG/W/34, para. 15.