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Chapter IV: Issues Regarding Notification to the WTO of a Regional Trade Agreement

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Chapter IV

ISSUES REGARDING NOTIFICATION TO THE WTO OF A REGIONAL TRADE AGREEMENT

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A. The WTO provisions

Regional trade agreements (RTAs) have operated as legally permitted exceptions to the GATT/WTO, under various provisions, since the GATT was established in 1945. This permission for RTAs within the multilateral trading system that favours non-discrimination among members reflects the reality of trading situation among countries. At Doha Ministerial Conference launching a new round of negotiations, for example, WTO members stressed their commitment to the WTO as "the unique forum for global trade rule-making and liberalization, while also recognizing that regional trade agreements can play an important role in promoting the liberalization and expansion of trade and in fostering development."

The examination and reporting on RTAs within the former GATT, and now the WTO, applies to both RTAs involving reciprocal exchanges of trade preferences, and agreements featuring non-reciprocal exchanges of preferences, mostly from developed countries (individually or jointly) to developing countries. The former type of RTAs, the subject of this paper, involve two broad and distinct categories; those affecting trade in goods and those affecting trade in services (Uruguay Round). In cases where the reciprocal exchange of trade preferences covers both goods and services, which is increasingly the norm for recent RTAs, the two regimes would be submitted to two separate WTO examination and review processes. RTAs involving reciprocal exchange of preferences are further sub-divided into those involving developing countries only, those involving only developed countries, those involving only countries with economies in transition, and mixed agreements between developed and developing countries and countries with economies in transition

RTAs on goods constituted by developing countries are subjected to the provisions of the Enabling Clause agreed in the Tokyo Round of multilateral trade negotiations. Prior to 1979, developing country RTAs like the Latin American Free Trade Area (LAFTA), were notified to GATT under the terms of GATT Article XXIV or GATT Part IV.

GATT Article XXIV and the Understanding on the Interpretation of Article XXIV of GATT 1994 (Uruguay Round result) apply to non-developing country RTAs liberalizing trade in goods. There is no provision preventing a developing country member of a free trade area or customs union to notify and seek an examination of their RTA under the provisions of GATT Article XXIV. It could be argued that RTAs among developing countries could become stronger in respect of the attainment of free trade and customs union, if they conform to GATT Article XXIV.

RTAs affecting trade in services are subjected to GATS Article V (Uruguay Round result). This covers all RTAs including those formed by developing countries.

GATT Article XXV (on waivers) and the Understanding in Respect of Waivers of Obligations under the GATT 1994 (Uruguay Round result) provide the legal basis for a number of preferential trading arrangements, in particular non-reciprocal preferences provided by developed countries (individually or jointly) to developing countries. Recently the WTO Article IX has been used for waivers.

B. GATT 1994 disciplines (RTAs in goods)

1. GATT Article I:2 (Grandfathering)

During the course of work on tariff-cuts and trade rules from 1946-1947 in the framework of the drafting of a charter of the International Trade Organization, it was recognized that a number of the founding GATT contracting parties operated preferential trading schemes. These schemes were in clear violation of the MFN principle of non-discrimination (GATT Article I) that was being promulgated. It thus became apparent that some provision was required to cater for this anomaly, establishing the basis for the GATT Article I:2.

GATT Article I:2 explicitly exempts in perpetuity (grandfathers) from the MFN requirement certain preferential arrangements existing at the time the GATT came into force. These included the British Imperial Preferences, preferences granted by the Benelux customs union and the United States, preferences in force in the French Union, those exchanged between Chile and its neighbours, and the preferences granted by the Lebanon-Syrian Customs Union to Palestine and Transjordan. The grandfathered preferences were limited by a requirement that they could not be raised above existing levels (those in force in 1947). Moreover, their significance has been steadily eroded over the past few decades by successive rounds of GATT tariff negotiations and reductions, and some of them have since ceased to exist.

2. GATT Article XXIV and the Understanding on Free Trade Areas, Customs Unions and Interim Agreements

GATT Article XXIV permits departures from the cardinal MFN obligation of non-discrimination within free trade areas, customs union or interim arrangement leading to the formation of free trade area or customs union. GATT Article XXIV grants a group of WTO members' permission to constitute themselves into a customs union or a free trade area and have totally free trade or reduced levels of duties and other trade restrictive regulations among themselves on trade in goods without the obligation of extending such treatment to other members. The permission is conditional; it is granted to RTAs, which promote trade among the participants without raising barriers to non-participants. This is the basic tenet of GATT Article XXIV, which is then clarified in the Article's operative paragraphs 1 to 12 and improved upon in the Understanding on the Interpretation of Article XXIV of GATT 1994.
The provisions of GATT Article XXIV apply to RTAs among countries other than developing countries as the latter are covered by the Enabling Clause (see section below). GATT Article XXIV mentions RTAs as consisting of one of the following three variants: a customs union, the most advanced form recognized by the Article; a free trade area; and an interim agreement leading to the establishment of either a free trade area or a customs union.

A *bona fide* customs unions is defined in GATT Article XXIV:8(a) as a single customs territory substituting for two or more customs territories and having the following two essential characteristics:

- Duties and other restrictive regulations of trade are eliminated on substantially all trade between the constituent territories of the union or at least with respect to "substantially all trade" in products originating in such territories (Article XXIV:8(a)(i)). Apart from this requirement, union members may still "where necessary" maintain duties or restrictions permitted under GATT Articles XI (quantitative restrictions); XII (restrictions applied for balance-of-payments reasons); XIII (non-discriminatory administration of quantitative restrictions); XIV (exceptions to the rule of non-discrimination), XV (exchange arrangements); and XX (general exceptions); and
- Substantially the same duties (essentially a common external tariff) and other trade regulations are applied by each of the members of the union to their trade with non-union members (Article XXIV:8(a)(ii)).

An authentic customs union with the above-mentioned features (or an interim agreement leading to the formation of such a customs union) would be permitted to operate in contravention of GATT Article 1 provided that it meets certain conditions.

One condition is the GATT Article XXIV:5(a) obligation stipulating that the duties (common external tariff) and other regulations of trade imposed on trade of non-participants shall not on the whole be higher, or more restrictive, than the general incidence of duties and other trade regulations applicable in the participants prior to the formation of the customs union or adoption of the interim agreement. In other words the single tariff of a customs union and other trade barriers should not be higher than the pre-union average. This “conformity test” under Article XXIV:5(a) is intended to ensure that customs unions or related interim arrangements perform their purpose of promoting trade among participants, while seeking to not unnecessarily raise trade barriers against non-participants. In the examination of most customs unions under the GATT/WTO, this “conformity test” has often been interpreted by some countries to mean an “economic test” relating to their trade creation and diversion impact of RTAs. In most cases, as in the EU customs union agreements, however, RTA participants have rejected the linkage while, at the same time, recognizing the importance of such an analysis, as there is no legal provision in place yet. They have emphasized that the examinations must be focused only on the conformity assessment. In the light of such differing interpretations, the economic test of trade creation/diversion has been identified as a systemic issue to be addressed by the WTO at a future date.

Another condition arises from the provisions of the Understanding in respect of the GATT Article XXIV:5(a) Obligation. The Understanding stipulates a quantitative measurement and attendant examination by the WTO of the general incidence of duties and regulations of commerce applicable before and after the formation of a customs union, to assess the conformity of the customs union to Article XXIV:5(a). The measurement in the case of duties and charges will be based on an overall assessment of the weighted average tariff rates and of custom duties collected, in accordance with the methodology used in the assessment of tariff offers in the Uruguay Round. For this purpose the duties and charges to be considered will be the applied rates of duty. The measurement will be undertaken by the WTO Secretariat on the basis of import statistics provided by the participants in a customs union or interim agreement. As regards non-tariff measures (other regulations of commerce), which are difficult to quantify or aggregate, a case-by-case examination may be required. Such as assessment have been conducted for some RTAs.

Another condition is the GATT Article XXIV:6 Obligation. If the adoption of a common external tariff by a WTO member of a custom union leads to an increase in its bound tariffs and thus becoming inconsistent with its previously negotiated schedules of tariff concessions as per GATT Article II, then the procedure for compensatory adjustment arising from the withdrawal or modification of schedules as set forth in GATT Article XXVIII (and the Understanding on that Article) shall apply. In essence, the procedure obliges participating custom unions to negotiate and agree with concerned WTO members, and consult other WTO members with a substantial interest in such concession, on adequate compensation. The understanding on GATT Article XXIV stipulates that the negotiations will be entered into in good faith with a view to achieving mutually satisfactory compensatory adjustments, including by way of compensatory tariff reductions in other products. In the negotiations due account shall be taken of the new market access opportunities created for the same product by decreases in tariffs of other union members. Should such negotiations fail to achieve any result within a reasonable period of time, the customs union shall be free to modify or withdraw the concession and other affected WTO members shall be free to retaliate by withdrawing substantially equivalent concessions. WTO members have invoked this provision; however, the use of this retaliatory provision has been rare owing either to successful compensatory negotiations or to the difficulty in targeting the offending country when the retaliation has to be done on an MFN basis.

A bona fide free trade area is defined in GATT Article XXIV:8(b) as a group of two or more customs territories within which the duties and other restrictive regulations of trade are eliminated on substantially all trade between the participants in products originating in their territories. It is, however, permitted that participants in the free trade agreement, “where necessary”, can maintain those restrictions permitted under GATT Articles XI, XII, XIII, XIV, XV and XX. In short, the free trade area must have the same characteristics as applied to internal trade within a customs union.

An authentic free trade area (or interim agreement leading to the formation of a free trade area) with the above-mentioned characteristic is accorded permission to operate in violation of the MFN principle provided that it promotes the trade of participants and does not raise barriers against trade with non-participants. This condition is stipulated in GATT Article XXIV:5(b) as follows: "the duties and other trade regulations in each of the FTA participants applied to trade with third countries at the formation of the free trade area or adoption of the interim agreement shall not be higher or more restrictive than the corresponding duties and other trade regulations existing in the same FTA participants prior to the formation of the free trade area or the interim agreement."

A bona fide interim agreement is defined in GATT Article XXIV:5 as an agreement that provides for the formation of a customs union or a free trade area as defined above. In reality the preponderant majority of RTAs consist of interim agreements, so for them the following GATT provisions pertaining to such agreements are particularly à propos.

The main obligation is stipulated in GATT Article XXIV:5(c) to the effect that an interim agreement can be permitted to operate as an exception to the MFN rule, provided that it shall include a plan and schedule for the formation of a customs union or free trade area within a reasonable length of time. This obligation is applied to curtail the potential for participants in interim agreements to use it as an excuse for introducing discriminatory trade preferences over an indefinite period. Some clarity has been introduced by the Understanding on GATT Article XXIV over the ambiguity on what constitutes a "reasonable length of time" for the duration of

an interim arrangement; the reasonable length of time should exceed 10 years only in exceptional cases, and in such cases a full explanation for a longer period should be provided to the WTO Council for Trade in Goods.

In addition, GATT Article XXIV:7(b) provides for WTO members together with the participants to an interim agreement to examine the above mentioned plan and schedule and make recommendations as to whether the interim agreement is likely to result in the formation of a customs union or free trade area within the foreseen period or whether such a period was unreasonable. Moreover, participants shall not maintain or implement the interim agreement if they are not prepared to modify it in accordance with the recommendations. This provision is difficult to enforce in practice as it implies that participants in the interim agreement should be, which is more often not the case, amenable to changing the consensus results of their internal RTA negotiations upon the recommendation of WTO. Past GATT practice, and one which is likely to continue under the WTO, shows that interim agreements are notified only after they have been agreed to and ratified by the participants, leaving no room for further changes.

A further obligation is stipulated by GATT Article XXIV:7(c) to the effect that parties to an interim agreement shall communicate any substantial change in the plan or schedule to WTO members which may request consultations with the participants if the change seems likely to jeopardize or unduly delay the formation of the customs union or free trade area.

The fundamental characteristic of a customs union or a free trade area under GATT Article XXIV provisions is "substantially all the trade" coverage. This concept has not been clearly defined, however, and the ambiguity has given rise to controversy in the past and difficulties are still encountered over its exact interpretation. Participants in RTAs have tended to interpret the principle as referring to the whole (horizontal) trade coverage and not to specific sectors. This interpretation allows a certain latitude as regards the product sectors covered. For example, many of the customs union and free trade agreements concluded by the EU have excluded the agriculture sector or certain portions of it, but which nevertheless cover a substantial portion of the overall trade between the EU and the parties concerned. These agreements, as far as the EU is concerned, meet the "substantially all trade" feature.

Other countries favour a definition that takes a sector-by-sector approach arguing that for this particular provision to be satisfied, no major sector of economic activity should be excluded from the coverage of the free trade/customs union. Proponents of this interpretation have thus argued that the EU agreements mentioned previously, by excluding the agricultural sector or parts of it, do not conform to the substantially all trade coverage feature. The different interpretations of “substantially all the trade” as to whether it refers to RTA trade in substantially all product sectors or substantial trade in all product sectors combined continues to impede the effective examination of RTAs under the WTO. This ambiguity was not clarified by the Understanding on GATT Article XXIV; it did not offer any clear definition of the concept. The CRTA has thus identified this concept as a systemic issue that it would address and clarify. However, such work should take place without prejudice to ongoing examination of RTAs under existing WTO provisions.

Another important obligation arises from GATT Article XXIV:7(a); it requires participants in customs union and free trade areas or associated interim agreements to promptly notify WTO members of the details (intent and content) of the particular RTA. This examination is an obligation to ensure transparency of the RTA and to ensure the conformity of the RTA with

relevant GATT provisions. The GATT Council decided on 25 October 1972 that notification of an RTA should be made following the signature of its constituent agreement. The practice has been for parties to the RTA to provide the legal text of the agreement to GATT members for their examination, normally by way of a working party established with the relevant terms of reference. Working party reports to the Council which adopts the report. GATT members acting jointly may reach a final decision on the conformity of the agreement with GATT Article XXIV or formulate other recommendations. The decision of the contracting parties is taken by a majority of votes cast; however, the tradition has been to adopt decisions by consensus, this is taken to exist if there is no formal objection to the decision by a member at the meeting when the issue is addressed. The examination process is now overseen under the WTO CRTA.

After the initial notification and examination process, participants in RTAs have to fulfil biennial reporting requirements. These requirements have been reiterated in the Understanding on GATT Article XXIV. Advantages accorded by a WTO member to adjacent countries in order to facilitate border/frontier trade/traffic is permitted under GATT Article XXIV:3.

It should be noted that the Understanding on the Interpretation of Article XXIV of GATT 1994 clarifies the interpretation of various provisions of GATT Article XXIV, but does not change the rules. The Understanding, in particular, requires an assessment of the general incidence of duties and trade regulations applicable before and after the formation of an RTA; determines that the "reasonable length of time" should not exceed 10 years (except in exceptional cases); and allows that the consistency of an RTA with GATT Article XXIV may be submitted to a dispute settlement panel. The latter is particularly significant in view of the creation of a more automatic and binding dispute settlement system under the new WTO Dispute Settlement Understanding.

In terms of the application of GATT Article XXIV, past experience has shown that some of the provisions that are used to judge the compatibility of free trade areas and customs unions within GATT are imprecise and have not been applied successfully. That is demonstrated by the fact that many free trade areas and customs unions have been examined by GATT working parties for consistency with GATT Article XXIV over the years, but such working parties have seldom reached any concrete conclusion. Also, the GATT review process simply became unable to handle the large increase in RTAs that have been notified to it. It was hoped that the introduction of the Understanding on the Interpretation of Article XXIV of GATT 1994 and ongoing efforts to clarify various provisions of GATT Article XXIV under the WTO framework would continually improve on the interpretation of the substantive provisions of GATT Article XXIV, and consequently provide for a more effective control of RTAs. This evolution must be seen in conjunction with the creation of the CRTA, which has had an impact on the procedures under which the WTO examines RTAs and because of its potential as a vehicle for assessing on a systemic basis the overall impact of such arrangements on the multilateral trading system.

3. Enabling Clause (RTAs among developing countries)

RTAs constituted by developing countries that affect trade in goods are subjected to the relevant provisions of the Enabling Clause agreed in 1979 in the Tokyo Round of multilateral trade negotiations. The Enabling Clause is formally called the "Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries – Decision of 28 November 1979." The adoption of this clause reflected a movement within the

former GATT from a very limited focus on addressing the concerns of developing countries, to an attempt to addressing these concerns specifically. The Enabling Clause has not been affected by the Uruguay Round, and continues to operate in its original form to this day.

Paragraph 1 of the Enabling Clause allows WTO members to provide differential and more favourable treatment to developing countries without according such treatment to other WTO members, and thus deviating from the MFN principle of non-discrimination (GATT Article I). Paragraph 2 of the Enabling Clause identifies the specific situations in which this permission (legal cover) is accorded (see Box 1).

Box 1. Enabling Clause provisions

Preferences accorded under the Generalized System of Preferences (GSP) schemes of developed countries. The Enabling Clause thus legalizes the GSP.

Provisions concerning non-tariff measures governed by provisions negotiated multilaterally under GATT including some of the Tokyo Round codes and some of the Uruguay Round provisions on non-tariff measures.

Special treatment of the least developed among the developing countries in the context of any general or specific measures in favour of developing countries.

Trade arrangements among developing countries on a regional or global basis involving the preferential reduction or elimination of tariffs. In respect of trade liberalization affecting non-tariff measures, these should be made in accordance with criteria or conditions, which may be prescribed by the WTO members. No such conditions or criteria have been prescribed so far. However, it has been proposed and opposed by some developing countries, as an issue that could be addressed within the context of the work of the CRTA on systemic issues in respect of "other regulations of commerce" affecting trade.

Bona fide RTAs among developing countries must satisfy the following conditions stipulated in the Enabling Clause, paragraph 3, if they are to benefit from its legal permission:

- They shall be designed to facilitate and promote trade of members and not raise barriers or create undue difficulties for the trade of third countries;
- They shall not constitute an impediment to the reduction or elimination of tariffs and other restrictions to trade on an MFN basis;
- They shall in the case of such treatment accorded by a developed member to developing member be designed and, if necessary, modified to respond positively to the development, financial and trade needs of developing countries; and
- They should be notified to the CTD when they are created, modified or withdrawn.

These provisions offer more flexibility and are less demanding than the provisions of GATT Article XXIV as further clarified by the relevant Understanding. There is no obligation to conduct an assessment of the ex-ante and ex-post level of protection of the RTA participants against third countries, to verify whether the RTA conforms to the test of not raising barriers against trade of non-participants. Although participants in RTAs would be required to argue and demonstrate that this is the case when they notify the RTA to the WTO. There is no obligation in respect of “substantially all the trade” criteria. No time limitation is specified for interim agreements, and biennial reports are not required of the RTAs. The only obligation is that the developing countries, which concluded an RTA, must notify the CTD when the RTA is created (signed and ratified), modified or withdrawn. The CTD may establish a working party upon the request of any interested member to examine the RTA in the light of the relevant provisions of the Enabling Clause.

The Enabling Clause has been invoked by developing countries that have notified their RTAs to the former GATT and now the WTO. In the period before 1979, RTAs among developing countries were notified to GATT under the terms of GATT Article XXIV, or under the terms of Part IV of GATT. Examples of agreements notified under the Enabling Clause in the period after 1979 includes the ASEAN free trade area, the Andean Pact and the Common Market for Eastern and Southern Africa (COMESA). When GATT was in existence, most RTAs among developing countries had not been notified.

4. GATT part IV (trade and development)

Part IV of GATT on Trade and Development was added to the GATT 1947 in 1965. It was not affected by the Uruguay Round results and continues to operate in its original form.

Part IV provides the basis for WTO members to provide special, advantageous treatment for developing country members. These include favourable market access conditions (Article XXXVI:4), especially for processed and manufactured exports (Article XXXVI: 5) in the hope of increasing the trade of developing countries and encouraging the diversification of their export capacity. The special treatment could be provided by way of a standstill, reduction and elimination of customs duties and other charges affecting products of current or potential export interest to developing countries (Article XXXVII). These measures could also be taken jointly by WTO members (Article XXXVIII).

Prior to the Enabling Clause of 1979, developing countries have justified the formation of RTAs among them on the basis of Part IV. Also, some developed countries have invoked Part IV, often in conjunction with GATT Article XXIV, as the legal basis for providing preferential non-reciprocal market access conditions to developing countries. This has been the case of EU in respect of the Lomé Convention, although other GATT/WTO members did not agree with the EU on its interpretation. The impasse in the GATT/WTO in the consideration of the Fourth Lomé Convention led the EU and ACP States to seek a waiver for the Convention, which was accorded up to February 2000 and later extended.

5. GATT Article XXV and the Understanding (waiver)

GATT Article XXV: 5 provides that under "exceptional circumstances," members acting jointly can waive an obligation imposed upon another member by GATT. It can therefore (and has been) invoked by members who, in breach of GATT Article I, want to enter into preferential trading arrangements. A waiver is typically requested if the parties to the preferential trading arrangement cannot comply with the terms of GATT Article XXIV (or the Enabling Clause). The decision to waive a GATT obligation of a member however shall be approved by a two-third majority of the votes cast and that such a majority shall comprise more than half of the WTO members (i.e., 74 members as of October 2004).

In the first two decades of GATT, a number of developed countries invoked GATT Article XXV:5 to form preferential trading arrangements. In 1948 France requested and obtained a waiver for a proposed customs union with Italy, which was not at that time a member of GATT. The founding members of the European Coal and Steel Community obtained a waiver in 1952 for their free trade agreement on coal and steel. The limited product coverage of the agreement meant that the parties could not invoke GATT Article XXIV, which required substantial trade coverage. Likewise the USA had to obtain a waiver in 1965 for its agreement with Canada on free trade in automobiles. Thus, GATT Article XXV has provided the basis

for authorizing the maintenance of a number of preferential trade agreements, especially sectoral trade agreements in contravention of GATT Article I.

However, the majority of the waivers that have been granted since the formation of GATT have involved preferences granted by developed countries to developing countries on a non-reciprocal basis in support of the latter's economic development. Most of these agreements drew their inspiration from Part IV of GATT. Examples include Australian preferences to products from Papua New Guinea (1953); Canada's preferences to imports from the Caribbean Basin (1968); USA preferences granted to Caribbean countries under the Caribbean Basin Economic Recovery Act (1985); and the preferences granted by USA under the Andean Trade Preference Act in 1992. One of more controversial waiver granted by GATT pertained to the Fourth Lomé Convention between the EU and the ACP States.

Recourse to the use of waivers has been limited by the Understanding in Respect of Waivers of Obligations under the GATT 1994 (Uruguay Round result). Apart from the obligation to justify the need for a waiver (Understanding paragraph 1), the Understanding provides (in paragraph 2) that all waivers existing as at the time the WTO Agreement entered into force (1 January 1995) shall lapse on the waiver's expiry date or not later than two years after the creation of the WTO (i.e., 1 January 1998), which ever comes first, unless extended in accordance with Article IX of the WTO Agreement.

Under the terms of the WTO Agreement Article IX:3 and 4, members who want to obtain waivers have to go through a complicated process before being authorized to deviate from their obligations under GATT. The waiver could be granted by the WTO Ministerial Conference in "exceptional circumstances," provided that the decision is taken by three fourths of WTO members (about 111 members at present count of 148 WTO members). However some flexibility is provided in terms of decision-making:

- Article IX:3(a) provides for the possibility that, upon request, the Ministerial Conference's decision on the waiver could be taken by consensus. In this case the Ministerial Conference shall establish a time period not exceeding 90 days to consider the request. Failing the reaching of consensus cannot be reached during that period, the decision would be taken by three fourths of WTO members.
- Article IX:3(b) provides for a waiver request concerning the multilateral trade agreements relating to trade in goods, trade in services and trade-related aspects of intellectual property rights, to be submitted initially to its relevant supervisory body, namely the Council for Trade in Goods, Council for Trade in Services or the Council for TRIPS, for consideration during a time period not exceeding 90 days. At the end of that period the relevant Council shall submit a report to the Ministerial Conference.

If a member (or group of them) should succeed in obtaining a waiver, it would have to abide by the stringent conditions that are likely to be set by the Ministerial Conference. Article IX:4 provides that the granting of the waiver shall clearly explain the exceptional circumstances justifying the decision, the terms and conditions governing the application of the waiver and the date of its expiry. If the waiver is extended over several years, it would be reviewed annually until its expiry. In each annual review the Ministerial Conference shall examine whether the exceptional circumstances continue to prevail and the relevant terms and conditions have been met, and on that basis extend, modify or terminate the waiver. This

provision introduces an element of uncertainty over the sustainability of a waiver with adverse implications for economic operators wishing to take advantage of it.

The provisions of the Understanding on the waiver and the WTO Agreement Article IX indicate that unless a WTO member (or a group of them) requesting a waiver could mobilize widespread support from other WTO members to support their request, they will not be able to easily obtain the waiver. This gives the impression that further use of waivers by WTO members as a basis for preferential trading arrangements that are not consistent with the provisions of GATT Article XXIV or the Enabling Clause is likely to diminish. Nonetheless, it can be possible as evidenced by the securing of the waiver by the EU and ACP States for the Cotonou Partnership Agreement from the 4th WTO Ministerial Conference in 2001.

C. GATS Article V (RTAs and trade in services)

GATS Article V allows an economic integration agreement liberalizing trade in services among parties provided the agreement:

- Has substantial sector coverage (in terms of number of sectors, volume of trade affected and modes of supply with no a priori exclusion of any modes); and
- Provides for the absence or elimination of substantially all discrimination through elimination of existing discriminating measures and/or prohibition of new or more discriminatory measures. Agreements liberalizing trade in services involving developing countries will be accorded flexibility regarding the above conditions. Such flexibility has not been further clarified; however, it would appear to imply a lower standard then what is expect from developed countries.

RTAs must be designed to facilitate trade of members and should not raise the overall level of barriers to trade in services within the respective sectors or sub-sectors compared to the level applicable prior to the entry into force of the agreement. RTAs must be promptly notified to the Council for Trade in Services on their creation and following any modifications. The RTAs liberalizing trade in services are permitted, under GATS Article V bis, to provide for full labour market integration on condition that: (a) the citizens of parties to the agreement are exempted from requirements for residency and work permits; and (b) the agreement is notified. A notification under this provision has yet to be submitted.

D. WTO Committee on Regional Trade Agreements

The GATT record in examining the various RTAs was not at all satisfactory. Of the 60 agreements notified under GATT Article XXIV, roughly one-half remained to be examined by a working party in the early 1990s. It had become difficult to find chairmen for such working parties and to organize their work. Moreover, almost all of those working party reports that were finished were inconclusive with no agreements reached by members on the consistency or not of the RTAs examined. It was also GATT practice to require periodic reports on the operation of RTAs. However, by the 1980s such reports were typically not made and the system of examining RTAs was hardly functional by the 1990s. It was falling desperately behind in producing working party reports and was not reviewing existing agreements at all on a systematic basis.

To address such problems, the CRTA was created on 6 February 1996 by the WTO General Council to centralize the examination and reporting of RTAs and assess their systemic

implications on the multilateral trading system (see Box 2). At the time of its creation, the CRTA replaced around 25 separate GATT working parties established to examine various RTAs. Its work focused on the examination of RTAs and it has started to look into the reporting obligation affecting RTAs and consideration of systemic issues.

1. The examination of RTAs

As of October 2004, a total of 110 agreements were under examination by the CRTA, 84 of these agreements were in the area of trade in goods and 26 in trade in services. Thirty-eight RTAs are undergoing factual examination, while for 32 RTAs, the CRTA had not yet started the factual examination. For the remaining 40 RTAs the factual examination has concluded that no progress was made on the completion of the corresponding examination reports. These RTAs were referred to the CRTA by the Council for Trade in Goods and the Council for Trade in Services. The CTD has not referred any RTA notified to it to the CRTA. One exception is the MERCOSUR agreement, which was examined under the GATT Article XXIV and the Enabling Clause. The other exception will be the examination of SADC free trade agreement under GATT Article XXIV. The examinations carried out so far indicate a major change from past practice. The examinations are critical and parties under examination are expected to show concrete and substantial prove of the conformity of their trading arrangements with relevant WTO provisions.

Box 2. Terms of Reference of the Committee on Regional Trade Agreements (CRTA)

- Carry out the examination of agreements in accordance with the procedures and terms of reference adopted by the Council for Trade in Goods, the Council for Trade in Services or the CTD, as the case may be, and thereafter present its report to the relevant body for appropriate action.
- Consider how the required reporting on the operations of such agreements should be carried out and make appropriate recommendations to the relevant body.
- Develop, as appropriate, procedures to facilitate and improve the examination process.
- Consider the systemic implications of such agreements and regional initiatives for the multilateral trading system and the relationship between them, and to make appropriate recommendations to the General Council.
- Carry out any additional functions assigned to it by the General Council.

The examination normally takes place in two phases. The first phase is an in-depth factual examination of the RTA in question with the relevant information provided by parties to the RTA in accordance with the Standard Format for Information on Regional Trade Agreements for RTAs affecting trade in goods and a similar one the Standard Format for Information on Regional Trade Agreements for RTAs affecting trade in services. The Standard Format would serve as a guide for RTA parties to furnish the basic information upon which the examination would be effected, in addition to the old GATT practice of questions and answers during the CRTA meetings and in written format. Though the use of the Standard Format is voluntary and non-binding, the practice so far in the CRTA has been to oblige RTA members to use it by refusing to examine RTAs for which the Standard Format is not available (thus postponing the examination). The Standard Format is an innovation of the CRTA in keeping with its mandate on establishing procedures to facilitate efficient and effective examination of RTAs. This first phase of examination is considered as completed when general agreement is reached within the CRTA that all relevant factual information has been supplied and reviewed.

The second phase comprises the drafting of a conclusion on the WTO conformity of the RTA in informal (confidential) setting. The conclusions can be influenced by the calculation of the general incidence of duties and other regulations of commerce applicable before and after the formation of the RTA. The calculation is conducted by the WTO Secretariat on the basis of

information (trade statistics and measures) provided by the parties to the RTA. The exercise is conducted with extreme caution as the results could be controversial (if the findings determine an higher incidence). However, there are some definition problems regarding "other regulations of commerce" for example; deficiency in intra-group trade data; and the precise calculation modality remain to be elaborated and agreed upon.

The factual examination and negotiated conclusions are amalgamated into a single report that is presented to the relevant supervisory body. As of October 2004, the CRTA had yet to release a report on the examination of an RTA to the relevant supervisory body.

2. The reporting of RTAs

The CRTA has considered in detail the procedures for giving effect to the obligation on regular reporting by parties to RTAs (biennially in the case of GATT Article XXIV RTAs). These related to the nature of biennial reports to be compiled, the factual information to be included, the coverage of RTAs and the objective and method of considering the reports.

The discussion within the CRTA on reporting generated broad agreement that the reporting should not constitute a new/repeated examination of an RTA (as carried out when the RTA was first notified). It should be an updated report on developments in an RTA. It must not overlap with reporting under the Trade Policy Review mechanism. Concern has been expressed by some WTO members that the clear demarcation between the reporting and examination obligations may become blurred, and that the reporting obligation may become unnecessarily burdensome. The EU is particularly concerned, as it will be affected the most as a major customer of the CRTA, given its many free trade and customs union agreements. Some CRTA members intend to evolve a link between the reporting requirement under GATT to those under GATS and the Enabling Clause, but other members have disagreed.

E. Doha negotiations on regional trade agreements

Paragraph 29 of the Doha Work Programme called for “negotiations aimed at clarifying and improving disciplines and procedures under the existing WTO provisions applying to regional trade agreements” while taking into account “the developmental aspects of regional trade agreements.” In accordance with this mandate, negotiations on rules have been pursued in the Negotiating Group on Rules. So far, progress has been limited. Initial submissions by some WTO Members emphasized the need for WTO disciplines to be more stringent and effective. The ACP States have submitted a proposal for greater flexibility and special and differential treatment in GATT Article XXIV for RTAs involving developed and developing countries. However, the focus of the Negotiating Group has been on procedural aspects to improve the WTO oversight function of RTAs in the CTRA. The WTO rules negotiations form a part of single undertaking under the Doha round.

The Doha negotiations on rules affecting RTAs provide a unique opportunity in the history of GATT/WTO to bring clarity, improvement and development-orientation to these rules. Presently, however, given the slow pace of negotiations on these issues, this challenge may not be fully addressed.

F. Issues for consideration by developing countries

1. Notifying an RTA is a must

Developing country WTO members are obliged to notify their RTAs to the WTO for examination and for a decision to be taken on its consistency with relevant WTO provisions. The purpose of the examination is to ensure compliance of the RTA with the relevant WTO provisions. It is the membership of the WTO which would agree on the conformity of the RTA undergoing examination. De facto, they have only exceptionally agreed on the conformity of a regional trade agreement. In almost all cases, including the EU (European Union), the examinations remained inconclusive, but without any effects on the implementation of the regional trade agreements by the concerned member States.

The practice in the WTO is for a notification to be made subsequent to (and not before) the entry into effect of the trade agreement. In order words, the notification is made after the implementation of the agreement has started. Thus, in most cases, the trade agreement would be notified after the ratification of the agreement by the signatory member States and its entry into operation. At times, for purposes of transparency countries have communicated to the WTO Council for Trade in Goods or Trade in Services, for example, their intention to form an RTA, provided some broad details about the agreement, and then notified it upon its enactment. Developing countries, and many other RTAs, have followed this path.

2. Notification procedures

The notification can be made by one member State (who is also a WTO member) of the RTA on behalf of the entire RTA, or by a group of members (all of whom are WTO members). A copy of the legal treaty must accompany the notification and the free trade area programme with all relevant documents like product liberalization list and the liberalization time schedule. The notification is addressed to the WTO Secretariat (Director General), which circulates the notification without the legal texts to the relevant WTO Council/Committee. The legal texts tend to be bulky and are kept in the Secretariat and made available to interested WTO members upon request.

The relevant WTO body which receives the notification is the CTD for agreements notified under the Enabling Clause, the Council for Trade in Goods for agreements notified under GATT Article XXIV, and the Council for Trade in Services for agreements notified under GATS Article V. With the exception of Enabling Clause agreements, the examination of all other RTAs is now centralized under the CRTA in contrast to the past GATT practice of constituting working parties. What happens in practice is that the WTO body to which an agreement is notified, adopts a standard terms of reference for the examination of the agreement and refers the agreement together with the terms of reference directly to the CRTA for the actual examination. The CTD has not referred any RTA notified under the Enabling Clause to the CRTA apart from the MERCOSUR agreement. However, while the examinations have been extensive in most cases, the CRTA had not yet released a concluding report on any of its examinations to the Council for Trade in Goods (or Council for Trade in Services). The CRTA's report of an examination and its conclusions are discussed in informal (confidential) settings. Enabling Clause agreements are examined by the CTD. However, the CTD might agree to refer the examination to the CRTA.

Developing country RTAs can thus be examined by the CTD, if notified under the Enabling Clause, or by the CRTA, if notified under GATT 1994 Article XXIV or GATS Article V. Also, even if developing country agreements are notified under the Enabling Clause, their examination could potentially be referred to the CRTA.

3. Notification under the Enabling Clause

Developing countries forming an RTA in goods should notify the agreement under the provisions (paragraphs 1 and 2) of the Enabling Clause. Most developing country agreements have been notified under this clause to the CTD, which may then establish a working party upon the request of any interested member to examine whether the RTA is in conformity with the provisions of the Enabling Clause.

The practice under the former GATT has been for the CTD or its working party to take note of the notification with little or no discussion. However, recent developments in the WTO and the growth of RTAs generally points toward the possible more substantive and lengthy examination of the RTAs, even those notified under the Enabling Clause. Developing countries members of RTAs should be prepared to provide an avalanche of documentation for the examination process and to ensure physical presence in Geneva whenever the examinations occur starting with the initial notification of the RTA. In addition, developing countries would have to complete and submit the Standard Format for Information on Regional Trade Agreements that is now used by the CRTA as the basic document on which to start examination. Furthermore, the GATT practice of questions and answers in oral sessions during the examinations and in writing if issues remain uncertified or pending has been maintained. There is greater likelihood of a lengthy question and answer procedure for RTAs. It can be expected that some WTO members may request information/studies/analyses on the likely trade creation and/or trade diversion effects of the RTA, even though there is no operative obligation regarding such trade effects under the Enabling Clause (nor under GATT Article XXIV and the Understanding). Also, RTA members can be asked to demonstrate that the level of tariff protection against third countries before and after the formation of the RTA has not changed upwards, although there is no legal obligation to this effect. There also will be heavy statistical requirements, which can be difficult to meet in view of the present poor state of foreign trade statistics of many developing countries.

Notwithstanding the above caveat, the provisions of the Enabling Clause offer more flexibility and are less demanding than the provisions of GATT Article XXIV and its Understanding. As noted previously, the only obligation under the Enabling Clause is that the countries' members of the RTA must notify the CTD when the RTA is created (signed, ratified and in operation), modified or withdrawn.

The absence of a pre-defined timetable for trade liberalization is a major advantage for developing countries, particularly LDCs, which may be facing considerable difficulties in liberalizing trade and adjusting to the new situated of heightened regional competition. They need a long transitional period, accompanied by investment-production measures to improve competitiveness and production capacity. At the same time it is necessary to periodically review the implementation and effects of special provisions in favour of LDCs, and examine how they are observing their own obligations. Developing countries should carefully consider both the needs and obligations of member States that are LDCs. The special treatment should relate both to trade commitments, as well as to effective implementation of joint measures to strengthen industrialization and competitiveness as well as to facilitate adjustment.

4. Notification under GATT Article XXIV and the Understanding

Developing countries can opt to notify any RTAs they have concluded among themselves under GATT 1994 Article XXIV and its Understanding. Such agreements are more or less automatically referred to the CRTA for an examination. This Article defines three types of agreements, i.e., a free trade area, a customs union and an interim agreement leading either to a free trade area or customs union as discussed previously.

An interim agreement, as stipulated by GATT Article XXIV:5(c), shall include a plan and schedule for the formation of the free trade area within a reasonable length of time. The Understanding on GATT Article XXIV clarifies that the "reasonable length of time" for the duration of an interim arrangement should exceed 10 years only in exceptional cases and in such cases a full explanation for a longer period should be provided to the WTO Council for Trade in Goods. A time period of 10 years or less will be in conformity with this critical test. However, developing countries, in particular, the LDCs may not be capable of fulfilling the requirements of trade liberalization within 10 years — a longer period may be necessary.

The RTA would also be tested to check whether it satisfies the definition of a free trade area, as defined in GATT Article XXIV:8(b) of a group of two or more customs territories within which the duties and other restrictive regulations of trade are eliminated on "substantially all trade" between the participants in products originating in their territories. There is no clear definition of the term “substantially all trade” and the CRTA is working on making it clearer. In the meanwhile, in most examinations so far, WTO members have tended to ask for qualitative and quantitative proof in terms of no exclusion of any sector of trade (especially agriculture), large coverage of in the range of 90 per cent of all tariff lines traded and the percentage of intra-trade affected. Member States would need to verify that the RTA meets at least one of these conditions so as to be in a position to defend the agreement on this crucial test.

There also is not clear definition of what constitutes “other restrictive regulations of trade” and the CRTA is working on providing more clarity here too. Thus no strict test can be applied. However, the point is to remove non-tariff barriers that impede trade even as tariff barriers are being eliminated. While this is a legal obligation, it is nonetheless in the trade interest of developing countries generally to remove non-tariff barriers to their mutual trade.

In addition countries would have to show evidence that their RTA promotes the trade of participants and does not on the whole raise barriers against trade with non-participants as stipulated in GATT Article XXIV:5(b). This provision essentially prevents that a country raises its MFN level of protection just before the entry into force of an RTA in order to start liberalizing from a higher level and/or to compensate customs revenue losses (this is also contrary to the interests of the member States of the RTA itself, as the first stages of mutual preferences are in fact nullified). Likewise, import quotas should not be made more stringent for third countries in order to compensate for higher import competitions from within the RTA area. If this happens, it would prejudice WTO acceptance of the RTA.

The examination is normally carried out over several CRTA sessions, but can take years if there are important diverging opinions. This is the case of NAFTA, for example. Such a prolonged examination would considerably increase the workload of the integration secretariat and developing country members, particularly when written answers have to be prepared for

the examination; there is also a non-negligible cost element. Defense of the RTA cannot be made solely by Geneva-based delegates from concerned member States. The questions that are asked are often quite technical and require an in-depth and up-to-date knowledge of the agreement. Integration secretariat staff invariably have to participate in the examination alongside the member States; this entails ensure that staff from the region attend CRTA meetings in Geneva until the examination is completed.

Also the Understanding on GATT Article XXIV introduces an examination of the impact of RTAs. It provides that the evaluation under GATT Article XXIV:5(a) of the general incidence of duties and regulations of commerce applicable before and after a formation of customs union shall be based upon an overall assessment of weighted average tariff rates and of customs duties collected. The result of the evaluation would be a major piece of evidence on which the CRTA would base its conclusions. Obviously, for any parties to an agreement being examined, a result that shows no change in the general level of protection is preferred.

With regard to the procedure to be followed when a WTO member forming an RTA proposes to increase a bound rate of duty, the Understanding reaffirms that the procedure set forth in GATT Article XXVIII must be commenced before tariff concessions under the free trade area or customs union enter into force. In negotiations for achieving mutually satisfactory compensatory adjustment as required under GATT Article XXIV:6, it is agreed that due account shall be taken of reduction of duties on the same tariff line made by other constituents of the customs unions upon its formation. Compensation in the form of reduction of duties should be offered by the customs union if such reductions are not sufficient to provide the necessary compensatory adjustment. However, when no agreement can be reached within a reasonable period from the initiation of negotiations, the RTA shall be free to modify or withdraw the concessions; affected members shall then be free to withdraw substantially equivalent concessions. The Understanding imposes no obligations to provide compensatory adjustments to members of a customs union.

The Understanding furthermore allows that the consistency of an RTA with GATT Article XXIV may be submitted to a dispute settlement panel. It is clear that dispute panels may consider GATT Article XXIV issues, if these are placed before it, and that the conclusions of the panels will be adopted.

Following the conclusion of the examination of the RTA, the CRTA would submit a report and recommendations to the Council for Trade in Goods. The report and recommendations is finalized during informal consultations among interested members of the CRTA. The Council may address recommendations to the RTA, i.e. its member States, to adjust provisions of their trade liberalization programme. The Council may also tie its acceptance of the RTA with certain conditions. There also is the consultation process to be observed in case of difficulties of individual WTO members with the RTA. Afterwards, the question of a dispute settlement panel might arise “on all matters”.

After the initial notification and examination process and hopefully positive concluding report, the RTA members would have to fulfil biennial reporting requirements. Thus the member States and the integration secretariat should be prepared every two years to provide a report to the WTO on the operation of the RTA and to engage in the debate over the report in Geneva. This requirement adds to the cost element of bringing the integration secretariat staff to Geneva to participate in the reporting exercise, and reporting on the updated changes.

So examinations under GATT Article XXIV are much more stringent and involve a high risk that there will be no ex ante agreement on the conformity of the RTA with WTO provisions. The standards of GATT Article XXIV and the Understanding are clearly greater and more stringent than those of the Enabling Clause.

G. Conclusion

The standards of GATT Article XXIV contain more stringent requirements that can be difficult to fully conform with by developing countries, in particular the LDCs. There is also the question of the financial costs of participating in WTO examinations and the biennial reporting. The Enabling Clause offers an easier option to meeting WTO consistency test. In any event, it is not evident that notification under the Enabling Clause would lead to an easy examination. In this light, it could be appropriate for developing countries to continue to notify the RTAs formed among themselves under the Enabling Clause. It provides them greater flexibility in forming RTAs, notifying them and operating them. Such flexibility will also be reflected in the instruments for liberalization under the agreements and thus providing developing countries with flexibility in commitments and trade policies.

In the final analysis, the choice of which WTO provision to notify an RTA remains a political one for developing countries members of an RTA to decide. Also, whatever the choice of legal instrument to notify the RTA, it must be not be under-estimated that the examination of the RTA will be difficult and adoption of a report on its consistency with WTO provisions will be matter of political negotiation with other WTO members.

Last, but not least, developing countries must work with skill and tenacity to use the opportunity afforded the by Doha negotiations on RTA rules to get the best of the deals in terms of clarity and improvements to the rules that enhance the development facilitating aspects of RTAs.