

Negotiating Group on Rules

COMPENDIUM OF ISSUES RELATED TO REGIONAL TRADE AGREEMENTS

Background Note by the Secretariat¹

The Negotiating Group on Rules, at its meeting of 8 May 2002, requested the Secretariat to prepare a background note which could assist delegations in the preparation of submissions and proposals in the context of paragraph 29 of the Doha Ministerial Declaration.²

The present note provides a compendium of issues related to regional trade agreements (RTAs) that have been generated by work within the Committee on Regional Trade Agreements (CRTA) and discussions in other WTO Bodies, from 1996 to date. Mention is also made to relevant findings in WTO panel and Appellate Body reports.

A structured checklist of issues is presented in Part I, to facilitate consideration. A more extended guidebook to the issues is found in Part II, including background information, as well as any comments or suggestions made on the subject.

Most of the issues summarized below refer specifically to the application or interpretation of existing WTO provisions applying to RTAs.³ Other issues are of a conceptual nature, interrogating the relationship between the multilateral and RTA approaches, or are associated to RTA characteristics highlighted by recent developments and not explicitly or fully covered by existing WTO provisions.

¹ Early distribution of this note in English aims at facilitating the preparation of submissions for the July meeting of the Negotiating Group. The French and Spanish versions will be circulated to Members well in advance of that meeting.

² «We also agree to negotiations aimed at clarifying and improving disciplines and procedures under the existing WTO provisions applying to regional trade agreements. The negotiations shall take into account the developmental aspects of regional trade agreements. »

³ See Annex for a brief account on these provisions.

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PART II

COMPENDIUM OF ISSUES RELATED TO RTAS

I. WTO BASIC TRANSPARENCY REQUIREMENTS ON RTAS

I.1. Notification

I.1.1 Definition of a time-frame for notification

1. The time at which an RTA should be notified by Members is not precisely formulated nor homogeneously expressed in WTO rules, as reflected in the provisions reproduced in the Annex. In practice, many RTAs are notified when their texts have already been sealed or even when the RTA is already in force, and it has been argued that this restrains the effectiveness of the ensuing examination process. It has been suggested that the terms «shall promptly notify» and «deciding to enter» in GATT Article XXIV:7(a) should be interpreted to mean that the notification and submission of information should take place, at least, before the entry into force of the RTA. Conversely, it has been observed that a case-by-case approach is more appropriate to take into account the complexity of issues surrounding RTAs, in particular the political and legal difficulties related to notifying an RTA prior to its ratification.

2. Determination of a specific time-frame for implementation of the «prompt notification» requirement in GATS Article V:7(a) has also been called for. A time-frame of «at least 90 days advance notice» (such as that stipulated under GATS Article V:5) has been suggested.

I.1.2 Dealing with non-notified RTAs

3. A number of RTAs currently in force have not been notified to the WTO, in particular preferential arrangements between developing countries. This is often cited as hindering any comprehensive and precise evaluation of the RTA phenomenon *vis-à-vis* the multilateral trading system. The current practice of raising questions about non-notified RTAs during WTO meetings has been considered insufficient as a means of gathering adequate information. It has been suggested that the possibility of counter-notification of RTAs be provided for.

I.2. Provision of information

I.2.1 RTA trade statistics to be made available

4. The quantity and quality of statistics requested from RTA parties has been highlighted in the context of the examination of RTAs under GATT Article XXIV.

5. It has been argued that full statistical information on trade is needed to conduct an RTA examination. It has been pointed out that major difficulties exist in cases where available statistics cover only a period prior to the RTA entry into force or the very first years(s) following its entry into force, in particular where significant transition periods are foreseen.⁴ Conversely, it has been observed that statistics are sometimes hard to obtain and may even prove misleading, given the dynamics of the economic integration.

⁴ It has been suggested that trade statistics should be provided for the years prior to, and following the, RTA's entry into force, as well as in the context of biennial reports. More specifically, they should be separated into agricultural and industrial products and should indicate, both in terms of trade flows and tariff lines, the percentage of the trade facing MFN, less-than-MFN and duty-free rates.

6. A recurrent question has been whether trade statistical data should also be made available on a tariff-line basis (i.e. not only on actual trade flows).⁵ This has raised legal controversy in the context of the assessment of individual RTAs' compatibility with the «substantially all the trade» requirement under GATT Article XXIV:8. (On this requirement, see Section V.1.1)

1.2.2 Other information to be made available

7. Detailed economic statistics have been considered necessary to facilitate the follow-up of the evolution of trade patterns and economic adjustments in RTA parties. Further, it has been suggested that parties to a given RTA should provide statistical information on trade they conducted under other preferential schemes, on the grounds that data on "overlapping" preferential arrangements is vital to understanding the relationship between RTAs and the multilateral trading system.

8. Discussions within the CRTA on how the provision of timely and accurate initial information on individual RTAs could be facilitated and standardized led its Chairman to establish non-binding guidelines in the form of standard formats.⁶ Since 1996-1997, parties to all notified RTAs have submitted initial information on the respective RTA under those formats.

I.3. Reporting obligations

9. With respect to periodic reporting on RTAs notified under GATT Article XXIV, an area closely linked to CRTA's work, feedback of WTO Membership at large on the operation of RTAs is deficient, despite efforts made to systematise the information furnished.

1.3.1 Biennial reporting on the implementation of customs unions and free-trade areas

10. In accordance with its terms of reference, the CRTA has revived the requirement for submission of biennial reports by adopting recommendations to its parent bodies on how the required reporting on the operation of RTAs should be carried out.⁷ Subsequently, calendars for the submission of biennial reports have been periodically issued by the Secretariat. While adherence to the first of such calendar has been relatively high, few biennial reports are still due for the 1999 calendar and the 2001 calendar.

11. Regarding objectives, Members have agreed that such reports «will serve to enhance transparency on how regional trade agreements are proceeding and as an input to the Committee's [CRTA] work under item 1(d) of its terms of reference»⁸ (i.e. the "systemic issues"), as stated in paragraph 1 of document G/L/286.

⁵ On the basis of a Secretariat's survey on *Coverage, Liberalization Process and Transitional Provisions in Regional Trade Agreements* (WT/REG/W/46), it has been noted that RTAs analysis by trade flows tend to overestimate product coverage in comparison with tariff line analysis.

⁶ Standard Format for Information on Regional Trade Agreements (WT/REG/W/6) and Standard Format for Information on Economic Integration Agreements on Services (WT/REG/W/14).

⁷ On the basis of recommendations adopted by the CRTA on 20 February 1998 (respectively WT/REG/4, WT/REG/5 and WT/REG/6) and sent to the Council for Trade in Goods (CTG), the Council for Trade in Services (CTS) and the Committee on Trade and Development (CTD), these bodies acted upon them in late November 1998 and invited parties to RTAs to elaborate periodic reports using, as far as possible, a Standard Format presentation (documents G/L/286, S/C/W/92 and WT/COMTD/16, respectively).

⁸ The contribution to the systemic debate is also referred to in the procedures related to reporting on agreements submitted to both the CTS and the CTD.

I.3.2 Reporting requirements for RTAs in the area of trade in services

12. GATS Article V:7(b) requires the parties to an RTA implemented on the basis of a time-frame to «report periodically» to the Council for Trade in Services (CTS) on its implementation. In that context, it has been proposed that periodic reporting should be extended to all economic integration agreements (EIAs), whether or not implemented in stages. It has been noted however that this would require a renegotiation of GATS provisions.

II. MULTILATERAL SURVEILLANCE MECHANISMS FOR RTAS

13. RTAs notified to the WTO are subject to surveillance in various Bodies, at various levels of depth and complexity, depending upon which provision the notifying Member avails itself of. On 6 February 1996, the General Council established the CRTA, partly with the aim of rationalizing RTA-related procedures contained in different WTO provisions. The Committee's terms of reference thus includes the examination of any notified RTA, if/as mandated by the relevant WTO body - an examination which had been until then the prerogative of separate *ad hoc* working parties. WTO Members also entrusted the CRTA with the additional task of considering RTAs' broader, systemic implications.⁹

II.1. Homogeneity of surveillance requirements

14. There have been claims of inadequate WTO surveillance of RTAs concluded among developing countries, in particular because these do not usually undergo examination, even when they take the form of free-trade areas (FTAs), customs unions or interim agreements leading to a customs union or a FTA (hereinafter, interim agreements). However, the *Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries* (hereinafter, the Enabling Clause), under which provisions such RTAs have traditionally been notified, irrespective of their nature, does not foresee any such examination.

15. The suggestion has been made that all RTAs (i.e. those notified under Article XXIV of the GATT 1994, the Enabling Clause and Article V of the GATS) should be notified to a single body, namely the CRTA, which would adopt the terms of reference for the examination, as appropriate. It has been noted however that this would require changes to existing legal provisions.

II.2. Adequacy of the examination process

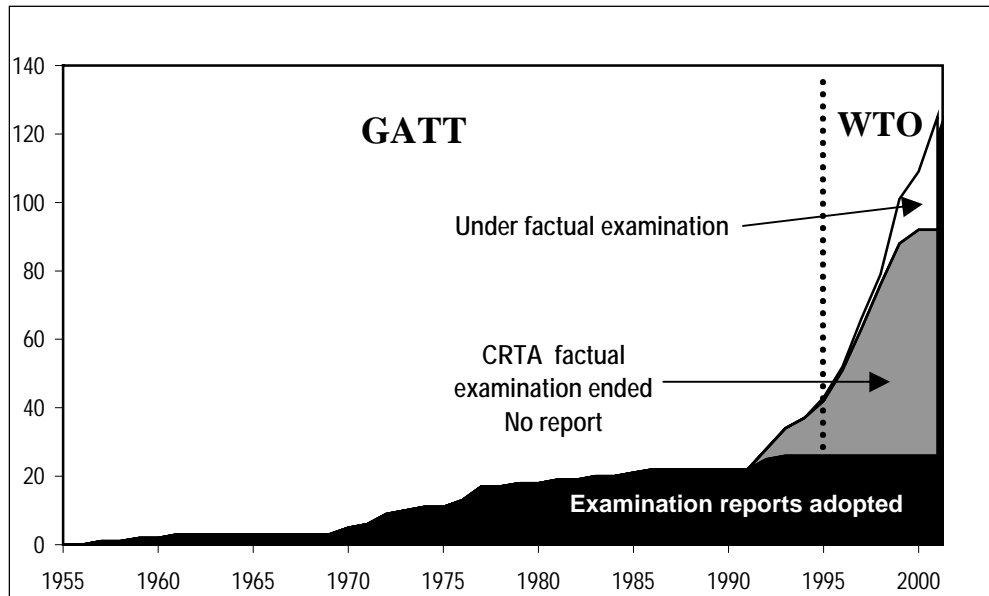
16. CRTA experience has underscored that the two intertwined purposes of RTA examinations - that is, gathering information about a given RTA and judging whether this RTA complies with the relevant legal criteria - form a problematic tandem. For several reasons, in particular because of Members' divergent understanding of the criteria contained in the rules themselves, the examination mechanism has persistently failed to serve these purposes adequately in the last four decades or so.

17. After the establishment of the WTO, increasing calls for, and efforts towards, RTAs transparency were partly checked by rising "dispute-settlement awareness". As a result, CRTA efforts towards improving examination procedures did not prevent the examination mechanism to be brought to near-paralysis *vis-à-vis* its two basic objectives, while there has been a plethora of RTA notifications.

⁹ The decision to establish the CRTA, with its terms of reference, is contained in document WT/L/127.

18. The chart below illustrates this impasse. For clarity reasons, it is based only on a subset of all RTAs notified to the GATT/WTO: those RTAs notified under GATT Article XXIV and known to be still in force on 31 January 2002.¹⁰

**Status vis-à-vis the examination process of
RTAs notified to the GATT/WTO under GATT Art. XXIV
and in force on 31 January 2002
(Cumulative figures)**



19. It is notable above that examination reports have only been adopted for those existing RTAs which were notified to the GATT and examined before the establishment of the WTO. In practice, the examination of RTAs notified between 1991 and 1994 only took off in 1996, within the CRTA. On none of these, nor on any of the RTAs notified since 1995, has it been possible to reach consensus on the format and language of the examination reports, despite the fact that, in most cases, the CRTA was able to put an end to the factual steps of the examination process. This notwithstanding that draft texts on examination reports for a few RTAs have been under informal consultations during the last four years, in an effort to reach a common approach.

20. This deadlock can be explained by the "dispute-settlement awareness" mentioned above, in particular in the current situation of absence of an agreed relationship between reports on the examination and dispute settlement cases: Members seem reluctant to provide information or agree to conclusions that could later be used or interpreted by a dispute settlement panel.¹¹ It has been noted that a further negative consequence of this deadlock is that WTO litigation may replace multilateral examination of an RTA (see section II.3.2).

21. Suggestions have been made on how to improve the situation, in particular by emphasizing the transparency aspects of the examination mandate.¹²

¹⁰ Out of a total of 250 notifications, 168 RTAs remain in force today. About 30 of these were notified under the Enabling Clause or GATS Article V.

¹¹ A suggestion that the examination of RTA consistency be left to the CRTA alone has been rejected.

¹² It has been suggested that examinations be carried out on the basis of a prior factual analysis of the RTA by the Secretariat. That, it has been argued, would set all Members on an equal footing and increase their understanding of the functioning of the agreements.

II.3. Suitability of the multilateral assessment of RTA consistency

22. The requirement for a multilateral consistency assessment of certain notified RTAs is contained in the provisions themselves, sometimes explicitly, as in GATS Article 7(a), sometimes implicitly, as in paragraph 7 of the *Understanding on the Interpretation of Article XXIV of the GATT 1994* (hereinafter, the 1994 Understanding) (see Annex). The meaning of "consistency" is also defined in paragraph 1 of the 1994 Understanding with respect to RTAs notified under Article XXIV.

23. Interrogations in this context mainly derive from the fact that only one of the examination reports adopted to date stated clearly that the RTA was found fully compatible with the relevant GATT rules, and that the examination process has not been able to deliver any kind of examination report in more than seven years.

II.3.1 Legal standing of RTAs vis-à-vis WTO rules

24. It has been argued that an RTA can be considered as tolerated or deemed compatible by the WTO in the absence of clear consistency conclusions being spelled out in the report on its examination, or when no such examination report exists.¹³ Conversely, it has been argued that the legal status of RTAs in the WTO can also be considered as remaining unclear, the rights of WTO Members under dispute settlement procedures being preserved in any event.

25. In the dispute *Turkey – Restrictions on Imports of Textile and Clothing Products* (hereinafter *Turkey – Textiles*) case, the Panel examined an argument put forward along the same lines as in paragraph 24 above. The Panel agreed with the findings of the GATT Panel in *EEC - Imports from Hong Kong*, which had 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».¹⁴

II.3.2 Panel's jurisdiction to assess compatibility of RTAs

26. While WTO rules provide for a multilateral assessment of the consistency of an RTA with the rules, the possibility of recourse to dispute settlement is explicitly referred to in paragraph 12 of the Understanding:

«Dispute Settlement

12. The provisions of Articles XXII and XXIII of GATT 1994 as elaborated and applied by the Dispute Settlement Understanding may be invoked with respect to any matters arising from the application of those provisions of Article XXIV relating to customs unions, free-trade areas or interim agreements leading to the formation of a customs union or free-trade area. »

27. With reference to the question of a panel's jurisdiction to assess the compatibility of RTAs, the Appellate Body, in the *Turkey – Textiles* case, stated:

«59. We 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. It may not always be possible to

¹³ The examination, which is a multilateral function (i.e. by the WTO Membership), should in principle include an assessment of the consistency of the examined RTA *vis-à-vis* relevant WTO rules. See a more detailed description in the Annex.

¹⁴ 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.

determine whether the second of the two conditions has been fulfilled without initially determining whether the first condition has been fulfilled. In other words, it may not always be possible to determine whether not applying a measure would prevent the formation of a customs union without first determining whether there *is* a customs union. In this case, the Panel simply assumed, for the sake of argument, that the first of these two conditions was met and focused its attention on the second condition.

60. More specifically, with respect to the first condition, the Panel, in this case, did not address the question of whether the regional trade arrangement between Turkey and the European Communities is, in fact, a "customs union" which meets the requirements of paragraphs 8(a) and 5(a) of Article XXIV. The Panel maintained that "it is arguable" that panels do not have jurisdiction to assess the overall compatibility of a customs union with the requirements of Article XXIV. We are not called upon in this appeal to address this issue, but we note in this respect our ruling in *India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products* on the jurisdiction of panels to review the justification of balance-of-payments restrictions under Article XVIII:B of the GATT 1994. The Panel also considered that, on the basis of the principle of judicial economy, it was not necessary to assess the compatibility of the regional trade arrangement between Turkey and the European Communities with Article XXIV in order to address the claims of India. Based on this reasoning, the Panel assumed *arguendo* that the arrangement between Turkey and the European Communities is compatible with the requirements of Article XXIV:8(a) and 5(a) and limited its examination to the question of whether Turkey was permitted to introduce the quantitative restrictions at issue. The assumption by the Panel that the agreement between Turkey and the European Communities is a "customs union" within the meaning of Article XXIV was not appealed. Therefore, the issue of whether this arrangement meets the requirements of paragraphs 8(a) and 5(a) of Article XXIV is not before us.» (footnotes omitted)¹⁵

II.3.3 *Burden of proof*

28. 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», noting a third party's argument that «since Article XXIV was an exception invoked by Turkey, it was for Turkey to bear the burden of proof».¹⁶ 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» (emphasis added)¹⁷

II.3.4 *WTO legal standing of parties to RTAs*

29. 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. The question is whether in the latter case WTO obligations continue to subsist and operate at the level of the original customs territories. It has been argued that a new legal entity is created when customs territories form a customs union, on the ground that a new commercial policy *vis-à-vis* third countries is then to be established.

30. 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:

¹⁵ Appellate Body Report, adopted on 19 November 1999 (WT/DS34/AB/R), paras. 59-60.

¹⁶ WT/DS34/R, paras. 9.57 and 9.58.

¹⁷ WT/DS34/AB/R, para. 59. (See also paragraph 32 below.)

«... 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».¹⁸

III. RELATIONSHIP BETWEEN RTA-SPECIFIC WTO DISCIPLINES AND OTHER WTO RULES

III.1. Article XXIV* and the Enabling Clause within GATT 1994 and the WTO Agreement¹⁹

31. The major question is whether Article XXIV should be considered as a derogation from the MFN obligation (Article I of the GATT) only, or from other GATT provisions as well. Historically, both views have co-existed in the Membership.

32. In the *Turkey – Textiles* case, the Appellate Body 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.»²⁰

33. It has been noted that the granting of waivers for preferential trading agreements concluded between developing and developed countries has faced difficulties in the recent past. In that context, it has been argued that given the significant role played by them, and in accordance with the Doha Ministerial Declaration, negotiations should take into account the developmental aspects of RTAs so that any new rules on RTAs protect the interests of developing and least-developed countries.

III.2. Links between GATT Article XXIV* provisions and the rules contained in other WTO Agreements in the area of goods

34. There is no agreed definition of the expression «other [than duties] regulations of commerce» as used in GATT Article XXIV:5. In turn, only in one instance the Agreements concluded in 1994 on non-tariff matters in the goods area refer specifically to RTAs (that is, in footnote 1 to Article 2.1 of the Agreement on Safeguards). At the same time as multilateral non-tariff trade-policy disciplines were developing well beyond the original GATT rules, Article XXIV provisions with respect to these matters have thus remained static, and their relationship with the new disciplines undefined.

35. That issue surfaced again in the Council for Trade in Goods (CTG), at the time of adoption of the terms of reference for the examination of the first RTA notified to the WTO.²¹ The terminology of such examination mandate would normally refer only to the GATT 1994: «to examine, in light of the relevant provisions of the GATT 1994 ...», without specifying whether the examination might also

¹⁸ WT/DS34/R, paras. 9.183-184.

¹⁹ Hereinafter, any reference to Article XXIV* (with an asterisk) includes the provisions contained in the 1994 Understanding, unless otherwise specified.

²⁰ WT/DS34/AB/R, para. 58. That reversed the Panel finding that Article XXIV did not authorize a departure from GATT/WTO obligations other than Article I of the GATT (WT/DS34/R, paras. 9.186-9.188).

²¹ The enlargement of the EC to include Austria, Finland and Sweden.

be carried out against the background of all WTO Agreements relating to trade in goods. It was then decided to expand those 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».²²

These terms of reference (including the above understanding) became standard for all subsequent examinations of RTAs notified under GATT Article XXIV.

III.2.1 Agreement on Textiles and Clothing (ATC)

36. In the *Turkey – Textiles* case, the Appellate Body noted that:

«The chapeau of paragraph 5 [of Article XXIV] refers only to the provisions of the GATT 1994. It does not refer to the provisions of the ATC. However, Article 2.4 of the ATC provides that "[n]o new restrictions ... shall be introduced except under the provisions of this Agreement or relevant GATT 1994 provisions. In this way, Article XXIV of the GATT 1994 is incorporated in the ATC and may be invoked as a defence to a claim of inconsistency with Article 2.4 of the ATC, provided that the conditions set forth in Article XXIV for the availability of this defence are met.»²³

III.2.2 Agreement on Safeguards

37. Relevant Appellate Body findings in the *Turkey – Textiles* case were reflected as follows in the Report of the Panel on the dispute *United States – Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities* (hereinafter *US – Wheat Gluten*):

«Furthermore, we understand that Article XXIV of the GATT 1994 may provide a defence to a claim of violation of a provision of the GATT 1994, and may also provide a defence to a claim of inconsistency with a provision of another covered agreement if it is somehow incorporated into that provision or agreement» (footnotes omitted).²⁴

However, the Panel did not examine whether Article XXIV of the GATT 1994 might provide a defence to a violation of a provision of the Agreement on Safeguards, given that such argument had not been presented by the United States.²⁵

38. Another issue refers to the lack of a multilaterally agreed methodology on how should safeguard measures already in place within a customs union be applied by acceding parties.²⁶

²² See WT/REG3/1. This same understanding applies *mutatis mutandis* to FTAs.

²³ WT/DS34/AB/R, footnote 13 to para. 45.

²⁴ Panel Report on *US – Wheat Gluten*, adopted on 19 January 2001 (WT/DS166/R), para. 8.180.

²⁵ While the United States argued that Article XXIV of the GATT 1994 would provide it with a defence to a violation of Article XIX of the GATT 1994, it stated in the Panel proceedings its understanding that "Article XXIV provides neither an exception nor a derogation to the provisions of the Safeguards Agreement". See WT/DS166/R, para. 8.181.

²⁶ This can also refer to anti-dumping measures.

III.2.3 Other WTO Agreements

39. The Agreement on Agriculture does not specify 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.

40. The Agreement on Rules of Origin does not contain disciplines on non-preferential rules of origin. No multilaterally agreed guidelines exist, apart from the Common Declaration with Regard to Preferential Rules of Origin annexed to the Agreement, which might be used in dealing with issues raised with respect to RTA rules of origin.²⁷ (See Section V.3.1)

III.3. Article V within the GATS (and its Annexes)

41. One major issue is the precise scope of the exemption for EIAs provided by Article V and in particular whether Article V allows departures from any other obligations than the MFN. It has also been argued that if that was the case, derogation from the other key principles of the GATS - such as transparency, fair administration of domestic regulations and emergency safeguards - should not be allowed.

III.3.1 Links between EIAs' trade liberalization requirements and GATS "exempted" services sectors/modes of supply or GATS provisions subject to further negotiations

42. One issue refers to whether an EIA can exclude from its coverage sectors or modes of supply which are not subject to the GATS disciplines, either in its totality - such as services supplied in the exercise of governmental authority - or partially - e.g. transport sector or certain Mode 4 aspects. If that is not possible, the question remains on the extent of the coverage required on such sectors for the EIA to be consistent.

43. Another issue relates to how to interpret Article V:1(b) requirements to eliminate discriminatory measures on intra-trade in view of further negotiations contemplated under various GATS Articles and Annexes.

III.3.2 Relationship between national jurisprudence and the GATS

44. One issue relates to the application of the "grandfathering concept" to EIAs.²⁸ 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. Such amendments could be required in cases where national jurisprudence conflicted with existing GATS rules, and possibly also in the event of future modifications of GATS rules.²⁹

²⁷ 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 provides disciplines for preferential rules of origin; in particular, Article 3(c) requires that laws and regulations relating to them be published "as if they were subject to, and in accordance with, the provisions of Article X of GATT 1994".

²⁸ The question of grandfathering, or conversely the retroactive application of new rules, has also been raised in the context of RTAs in the goods area.

²⁹ Article V:7 requires the notification of all EIAs in force, including those signed before the entry into force of the GATS. Thus, at least in the case of notification under the GATS, grandfathering does not exist.

IV. INTERDEPENDENCE OF RTA-SPECIFIC WTO DISCIPLINES

IV.1. Links among provisions within GATT Article XXIV*

IV.1.1 Significance of the provisions of paragraph 4

45. A recurrent general question has been whether paragraph 4 of Article XXIV contains additional requirements to those specified in paragraphs 5-8 or should be viewed as merely introducing these provisions.³⁰ In this respect, the Appellate Body Report in the *Turkey – Textiles* case stated 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».³¹

46. Within this general setting, it has been questioned whether RTA parties are required not to increase the barriers overall or rather not to raise any barrier, with reference to the phrase «not to raise barriers» towards third parties in paragraph 4 and the corresponding concept in paragraph 5(a). 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 assessing compatibility.³²

Both these findings were shared by the Appellate Body, which added that «the text of the chapeau of paragraph 5 should be interpreted in its context», and identified paragraph 4 as an import element in that context. This led the Appellate Body to state:

«According to paragraph 4, 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. This objective demands that a balance be struck by the constituent members of a customs union. A customs union should facilitate trade within the customs union, but it should *not* do so in a way that raises barriers to trade with third countries.»³³

IV.1.2 Relative precedence of paragraphs 4-5 provisions and those found in paragraph 8

47. This issue has been raised in particular with respect to the possible impact of compliance with the requirement concerning common trade policy in a customs union contained in paragraph 8(a)(ii); more generally, it refers to cases where a measure ostensibly taken within an RTA to facilitate intra-trade would have a trade-restrictive effect on third parties.

48. It has been argued 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.

49. Some findings of the Panel and the Appellate Body in the *Turkey – Textiles* case, such as those reported in paragraphs 45-46, may shed light on that issue.

³⁰ Reaffirmed in the fifth paragraph of the Preamble to the 1994 Understanding.

³¹ WT/DS34/AB/R, para. 57.

³² WT/DS34/R, para. 9.121.

³³ WT/DS34/AB/R, paras. 55-56.

IV.1.3 Parallelism between provisions applying to customs unions and those applying to FTAs

50. Paragraph 5 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 is found in subparagraph (a) for customs unions and in subparagraph (b) for FTAs. While language therein is largely symmetrical, it contains some differences:

- subparagraph 5(a) states that the duties and other regulations of commerce «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 these expressions 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».
- subparagraph 5(b) provides that the corresponding comparison for FTAs should be based on the duties and other regulations of commerce «maintained in each of the constituent territories and applicable at the formation» of the FTA and those previously «existing in the same constituent territories». Such differences in wording shed doubts on whether «applicable» duties for FTAs refer to bound rates or to applied rates.

51. It has been argued that a consistent interpretation of paragraph 5 would require that duties «applicable» by FTA parties refer to applied rates just like in the case of a customs union (see Section V.3.3 for a related question). Some findings of both the Panel and the Appellate Body in the *Turkey – Textiles* case are also relevant in this respect (see paragraph 46 above).

52. Another issue raised relates to the definition of the expression «other regulations of commerce» itself. It has been observed that, under Article XXIV:5, it might have a wider scope for FTAs than for customs unions, especially if, as it has been argued sometimes, FTA rules of origin should be considered as a regulation of commerce in that context. (see Section V.3.1)

IV.1.4 Congruity of provisions in paragraph 8 with those contained in paragraph 5

53. Paragraph 8 provides for the minimum parameters which parties to a customs union or FTA must meet in shaping their internal trade relations, whereas paragraph 5 governs external relations.³⁴

54. It has been pointed out that RTAs, in complying with paragraph 8 disciplines to achieve internal trade liberalization, in particular in the area of «other restrictive regulations of commerce», might raise barriers to the trade of third parties, in contradiction with paragraph 5 requirements. The application or harmonization of standards (both technical barriers to trade and sanitary and phytosanitary measures), as well as the introduction and enforcement of competition law, have been cited as possible fields where this could apply; hence the need to analyze the intent and application of the «other restrictive regulations of commerce» in operation in RTAs.

IV.1.5 Relevance of provisions applicable to RTAs implemented by stages

55. In the GATT/WTO history, though most customs unions or FTAs have been, at least in part, implemented by stages, very few have expressly been notified as «interim agreements». As a

³⁴ Paragraph 8(a)(ii), which deals with harmonization of the external trade regime in a customs union, is less unambiguously "internal" in this respect.

consequence, many of the detailed provisions specifically devoted to this type of RTA, both in Article XXIV and in the 1994 Understanding, have practically become redundant.³⁵

56. In that context, it has been noted that multilateral surveillance of RTAs would be increased if interim agreements were notified under Article XXIV:5(c) of the GATT 1994, so that existing requirements on the plan and schedule for an interim agreement could be better monitored and, if required, recommendations on in particular «... the proposed time-frame and on measures required to complete the formation of the customs union or free-trade area» (paragraph 8 of the 1994 Understanding)) could be made by Members, and further review of the agreement foreseen.

57. Unclear issues related to transition periods have however been highlighted in examinations of RTAs notified under Article XXIV, though in isolation from other disciplines for interim agreements:

- Could RTA parties apply a longer (than 10 years) transition period to some products instead of excluding them from the scope of the agreement straightaway?
- What should be expected as a «full explanation» by parties to an interim agreement with transitional periods longer than 10 years?
- 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?³⁶
- Should consideration of the «other restrictive regulations of commerce» (paragraph 8) and the «other regulations of commerce» (paragraph 5) be different in fully implemented RTAs and interim agreements?³⁷

IV.2. Links among provisions within GATS Article V

IV.2.1 Relationship between the tests on «substantial sectoral coverage» and on «substantially all discrimination»

58. One view 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, the sector would be considered as not covered if it did not satisfy the requirements under Article V:1(b).

59. Another view is that the two tests are separate and that 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); Article V:1(a) would determine the proportion of sectors or subsectors subject to liberalization, while Article V:1(b) would determine whether discriminatory measures maintained in service sectors or modes of supply are acceptable.

IV.2.2 Relationship between establishment requirements and the test on «substantial sectoral coverage»

60. The question has been raised on whether a requirement for foreign suppliers to establish themselves in local jurisdiction before they be allowed to sell services to local consumers amounted to

³⁵ Paras. 5(c), 7(b) and 7(c) of GATT Article XXIV and paras. 3 and 8-10 of the 1994 Understanding deal with interim agreements.

³⁶ It has been argued that paragraph 8 requirements (in particular with respect to «substantially all the trade») should apply only at the end of the transition period, while those of paragraph 5 should apply both during and at the end of the transition period

³⁷ It has been noted 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.

an *a priori* exclusion of cross-border trade in these services. If that was considered a violation of the requirements of footnote 1 to Article V:1(a), the question has been posed on how that situation would be viewed in cases where individual sub-national governments impose an establishment requirement for inter-state trade within that country.

IV.2.3 Relationship between the flexibility provided to EIAs involving developing countries and various GATS requirements

61. 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.» The issue is whether the more favourable treatment should be limited by the requirements of Article V:4 so that the «overall level of barriers» in each sector and subsector is not raised.

IV.2.4 Compensation negotiations under paragraph 5 and its possible application to modifications in MFN exemptions

62. 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».

63. Though Article V:5 relates to compensation to third parties only in the context of specific commitments, an issue emerged on the possibility of providing compensation for the extension of MFN exemptions by a customs union to its area of enlargement.

64. It has been suggested that such extended MFN exemptions qualify as new measures, with the relevant provisions being those contained in the Annex on Article II Exemptions and in Article IX of the WTO Agreement. MFN exemptions and specific commitments were completely different issues and legal provisions dealing with the latter could not be used for modifications in the former.

65. Conversely, it has been suggested that the automatic extension of an MFN exemption implies that third countries would not benefit from the same access to the markets of acceding parties; that situation could be assimilated to the one where commitments undertaken are modified or withdrawn. Thus, compensation according to the Article XXI route, as provided for in Article V:5, would be applicable. (see Section VI.3.6)

V. INTERPRETATION OF PARTICULAR WORDING CONTAINED IN GATT ARTICLE XXIV

V.1. Meaning of «substantially»

66. The word «substantially» is found three times in the provisions of paragraph 8, where it is defined what should be understood by «customs union» and by «free-trade area».

V.1.1 Paragraph 8(a)(i) and 8(b): «substantially all the trade»³⁸

67. In a customs union, according to paragraph (a)(i), duties and, apart from permissible exceptions,³⁹ other restrictive regulations of commerce should be «eliminated» with respect to «substantially all the trade» between the parties «or at least ... substantially all the trade» in

³⁸ Often also referred to as an RTA's "product coverage".

³⁹ «... (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) ...».

originating products. A similar requirement is contained in paragraph (b) for FTAs: that such elimination be made on «substantially all the trade» in originating products.

68. Despite the inclusion of the fourth paragraph in the Preamble to the 1994 Understanding,⁴⁰ the interpretation of that expression has remained contentious. Two approaches, not mutually exclusive, are typical in that respect:

- A quantitative approach favours the definition of a statistical benchmark, such as a certain percentage of the trade between RTA parties, to indicate that the coverage of a given RTA fulfils the requirement.
- A qualitative approach sees the requirement as meaning that no sector (or at least no major sector) is to be kept out of intra-RTA trade liberalization; this approach aims at preventing the exclusion from RTA liberalization of any sector where the restrictive policies in place before the formation of the RTA hindered trade, which could be well the case if a quantitative approach was used.

69. Apart from calls aiming at defining RTAs' coverage as meaning that all sectors should be included, it has been suggested that the above two approaches could be bridged or complemented by:

- characterizing an RTA's product coverage not only in terms of trade flows but also in terms of a certain percentage of tariff lines;⁴¹
- as a refinement to the quantitative approach, calculating the percentage of trade between the parties carried out under RTA rules of origin; and/or
- exploring whether footnote 1 to GATS Article V provides a basis for some clarification of the «substantially all the trade» concept.⁴²

V.1.2 Paragraph 8(a)(ii): «substantially the same duties and other regulations of commerce»⁴³

70. Paragraph 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, i.e. provides from a certain harmonization of the external trade regime of the constituent members of a customs union.

71. Concerning the extent of harmonization required, in the *Turkey – Textiles* case, the Panel found that the flexibility provided for in 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 were 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.»⁴⁴

⁴⁰ «Recognizing also that such contribution ... if any major sector of trade is excluded».

⁴¹ A threshold has also 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.

⁴² 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».

⁴³ Often also referred to as an RTA's "product coverage".

⁴⁴ WT/DS34/R, para. 9.151.

While agreeing with the Panel that the phrase «substantially the same» in 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.⁴⁵

72. With respect to the related question of whether otherwise GATT-inconsistent measures could be harmonized under the legal cover of Article XXIV, reference is made to the Appellate Body findings in the *Turkey – Textiles* case, as reflected in paragraph 32 above.

V.2. Scope of the bracketed exceptions in paragraph 8: Application of global safeguards to RTA partners

73. The expression «other restrictive regulations of commerce», which is found twice in paragraph 8 has never been positively defined in the GATT/WTO.⁴⁶ Most interrogations in this respect are linked to the list of permitted exceptions to the internal elimination of «other restrictive regulations of commerce» in customs unions and FTAs, as contained in paragraph 8(a)(i) and 8(b), respectively.

74. The fact that neither GATT Article XIX nor Article VI are cited in that list has given rise to the general question of whether safeguard and anti-dumping measures should be considered as «other restrictive regulations of commerce» or not.

75. A more specific issue in this respect is the significance of the non-inclusion of Article XIX among the exceptions for WTO Members' rights and obligations, and its effects on the conditions of application of global safeguards to RTA parties.⁴⁷ Traditionally, that non-inclusion has been approached from three distinct, and mutually exclusive, viewpoints:

- It remains an obligation to apply global safeguards MFN, including to RTA partners; the bracketed list of exceptions being purely illustrative and Article XXIV not waiving the basic MFN principle for safeguard measures.
- It is permitted to apply safeguard measures to RTA partners, though only 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 parties.⁴⁸
- It is forbidden to apply global safeguard measures to RTA partners, since to consider the list of allowed «other regulations of commerce» as exhaustive conforms with common practice in cases of derogations from general principles.⁴⁹

⁴⁵ WT/DS34/AB/R, paras. 49-50.

⁴⁶ Neither has the expression «other regulations of commerce» in paragraph 5 and paragraph 8(a)(ii).

⁴⁷ Only a few agreements explicitly allow for the exclusion of RTA partners from a global safeguard action; in other agreements, this exemption is implicit.

⁴⁸ The flexibility embodied in that interpretation itself creates new interrogations concerning the possible exclusion of RTA parties from the application of safeguards, such as (i) whether a party would be allowed to exempt its partners from a global safeguard action depending on whether their imports accounted or not for a "substantial share" of total imports and contributed to "serious injury"; (ii) whether safeguards could be imposed on intra-trade only if determination was made that the injury was due to the reduction of duties contemplated in the RTA.

⁴⁹ Such prohibition would however not apply during the transition period.

76. Rulings by panels and the Appellate Body on WTO disputes concerning the application of safeguard measures have not given a definite response to the basic question above, i.e. whether exempting parties to a given RTA from a global safeguard measure was WTO-consistent. On the contrary, in the dispute *Argentina – Safeguard Measures on Imports of Footwear* (hereinafter *Argentina – Footwear (EC)*), the Appellate Body specifically stated the following:

«... we wish to underscore that, as the issue is not raised in this appeal, we make no ruling on whether, as a general principle, a member of a customs union can exclude other members of that customs union from the application of a safeguard measure.»⁵⁰

In the dispute *US – Wheat Gluten*, the Panel maintained that same approach, later agreed upon by the Appellate Body,⁵¹ by stating:

«We do not believe that we have been asked to rule, and consequently make no ruling, on whether or not, as a general principle, a member of a free trade area can exclude imports from other members of that free trade area from the application of a safeguard measure.»⁵²

In the more recent dispute *United States – Definitive Safeguard Measures on Imports of Circular Welded Carbon Quality Line Pipe from Korea* (hereinafter *US – Line Pipe*), in reversing the Panel's finding that:

«... the United States is entitled to rely on Article XXIV as a defence to Korea's claims under Articles I, XIII and XIX of GATT 1994, and Article 2.2 of the Safeguards Agreement, regarding the exclusion of imports from Canada and Mexico from the scope of the line pipe measure»,⁵³

the Appellate Body re-stated:

«We need not, and so do not, rule on the question whether Article XXIV of the GATT 1994 permits exempting imports originating in a partner of a free-trade area from a measure in departure from Article 2.2 of the *Agreement on Safeguards*.»⁵⁴

77. However, while inconclusive on the issue of the imposition or maintenance of safeguard measures between the constituent territories of a customs union or of a free-trade area in relation to Article XXIV, Panel and Appellate Body findings have stressed the need for a parallelism between the scope of a safeguard investigation and the scope of the application of safeguard measures.

V.3. Other issues

V.3.1 The qualification of RTA rules of origin as «other regulations of commerce»

78. RTA provisions on rules of origin have raised a number of issues. On the question of whether RTA rules of origin constitute an «other regulations of commerce» (ORCs) under Article XXIV:5, distinct interpretations subsist:

- RTA origin rules constitute an ORC.⁵⁵
- RTA origin rules do not constitute an ORC, given that by definition they do not affect trade with third parties.

⁵⁰ Appellate Body Report on *Argentina – Footwear (EC)*, adopted 12 January 2000 (WT/DS121/AB/R), para. 113.

⁵¹ Appellate Body Report on *US – Wheat Gluten*, adopted on 19 January 2001 (WT/DS166/AB/R), para. 99.

⁵² WT/DS166/R, para. 8.183.

⁵³ Panel Report on *US – Line Pipe*, adopted on 8 March 2002 (WT/DS202/R), para. 7.167.

⁵⁴ WT/DS202/AB/R, para. 198.

⁵⁵ It has been suggested that rules of origin play a similar role in a FTA as the one played by a common external tariff in a customs union.

- A case-by-case examination of the preferential rules of origin in RTAs is needed. That examination would clearly indicate whether these rules had restrictive effects on the trade *vis-à-vis* third parties.

79. Apart from this "definition" question, discussions on RTA provisions on origin rules also raised a number of technical issues. One question relates to whether it is appropriate to compare the rules of origin of a new RTA with those of an earlier RTA with overlapping membership which it superseded. Another issue is whether diagonal cumulation schemes contravene WTO rules, as they favour certain third-parties to a particular RTA, while discriminating against the rest.⁵⁶

80. More recently, it has been noted that a harmonization of RTA rules of origin might be desirable in the long run.⁵⁷ However, it has been argued that this might not be workable given that those rules derived from production and trade structures in place between the RTAs parties.⁵⁸

V.3.2 *Non-zero preferential tariff rates*

81. The question of the application of preferential tariffs lower than the MFN rates but higher than zero has been raised. It has been argued that such tariffs should be assessed in the context of paragraph 8, and while they fall short of having been eliminated, they contribute to the objective of facilitating trade and may in certain instances represent a first step towards an possible elimination of the duty at a later stage. It has also been noted that the requirement to eliminate duties apply to «substantially all the trade», and that Article XXIV is silent on the treatment of such "non-substantial" part of intra-trade.

82. Conversely, it has been argued that non-zero preferential tariff rates could not be justified under paragraph 8 which require their elimination, and not their reduction, but rather that they should be assessed in light of paragraph 5(b) as they amount to the raising of barriers *vis-à-vis* the trade with third parties.

83. An intermediate interpretation has been that the requirement for such elimination would apply at the end of the transition period, and that in between such non-zero preferential tariffs should be allowed as they amounted to a staged implementation of the elimination requirement. (see Section IV.1.5.)

V.3.3 *Compensation for negative effects on third parties upon the formation/enlargement of an RTA*

84. The need for elaborating disciplines aimed at ensuring that third parties are compensated for possible negative effects brought by the creation or enlargement of an RTA has been raised. Disagreement remains on whether existing provisions allow for such a request, and further on whether these would not go beyond the existing negotiating mandate.

⁵⁶ Under diagonal cumulation, materials supplied by specific countries not parties of a given RTA may be counted, under certain conditions, as originating from the RTA.

⁵⁷ This view was expressed in the context of the debate held on a recent Secretariat's survey on *Rules of Origin Regimes in Regional Trade Agreements* (WT/REG/W/45). That suggestion had also been made in the context of Uruguay Round negotiations.

⁵⁸ For some, that "tailor made" nature of RTA rules of origin generally resulted in more stringent than MFN rules of origin and seemed to be contrary to the objective of enhancing and facilitating trade between RTA parties. In that context, these origin rules could create obstacles on intra-trade; further, they would also create obstacles on trade with third parties given that stringent rules of origin tended to render more difficult the transformation of their materials into products originating within the RTA.

VI. INTERPRETATION OF PARTICULAR WORDING CONTAINED IN GATS ARTICLE V

VI.1. Meaning of «substantial» and «substantially»

VI.1.1 Paragraph 1(a): «substantial sectoral coverage»

85. 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 this expression 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. The main question that remains to be solved is the extent of liberalization needed for an EIA to meet the «substantial sectoral coverage» test.

86. Regarding the coverage of sectors, two approaches co-exist:⁵⁹

- Not all sectors must be covered under an EIA.
- The flexibility provided by the word «substantial» does not allow for the exclusion of a sector from an EIA. That has also been modulated by a suggestion that the exclusion of essential services (those which serve as infrastructure for economic activity, such as transportation) could not be possible and that the exclusion of major service sectors needed to be considered in conjunction with the modes of supply and the volume of trade involved.

87. Regarding 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.

88. Brief and inconclusive discussions were held on the adequate 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. 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 have been presented as arguments favouring a sector-by-sector examination.

89. The unavailability of reliable data on trade in services has been highlighted. It has been suggested that data on domestic economic activities could be used instead, with the statistics on the size of the domestic market of services sectors concerned or their contribution to GDP being used to determine the coverage of sectors. Further, it has been suggested that it was pointless to pursue the idea of percentages of sectors/trade excluded, but that an attempt should be made to define the volume of trade affected.

VI.1.2 Paragraph 1(b): «substantially all discrimination»

90. The extent to which discriminatory measures should be allowed to exist in an EIA without breaching its consistency with Article V:I(b)⁶⁰ is a debatable issue, although it is clear that those

⁵⁹ A number of more detailed questions have also been raised, namely (i) how to determine whether all sectors have been covered or not; (ii) how to calculate the volume of trade affected when a sector is less than fully liberalized; (iii) whether the calculation should only include that portion of trade in a sector that has been completely liberalized by the provisions of the EIA; (iv) if the setting of a percentage target could be feasible for examining the coverage of an EIA, whether it would be more appropriate to have a percentage target for the volume of services trade covered or of domestic services activity covered; and (v) 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.

permissible discriminatory measures 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). It has also been noted that the unavailability of detailed data on trade in services makes it difficult to arrive at a percentage-type test for quantitatively measuring «substantially all discrimination», which in turn should point towards a case-by-case examination of each agreement.

VI.2. Scope of the bracketed exceptions of trade restrictive measures

91. It has been argued that the list of exceptions allowing the maintenance of certain discriminatory measures is not exhaustive.⁶¹ Expansion of the list of exceptions has been considered permissible on the basis of the Preamble to 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.

92. Two interpretations of the application of emergency safeguards among parties to an EIA co-exist:

- Article X should 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.
- 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.

93. In addition to that safeguard issue, the possible illustrative nature the list of exceptions also raises the question of what other types of discriminatory measures (besides those enumerated in the list) should be considered as legitimate exceptions from the requirement in Article V:1(b) for the «absence or elimination of substantially all discrimination».

VI.3. Other issues

VI.3.1 Footnote to paragraph 1(a): nature and aim of its parameters

94. Concerning the parameters in the footnote, the question has been raised on whether they should be viewed as providing a basis for assigning weights to the sectors liberalized or as establishing three separate factors to be considered in making an overall judgement. Also, it has been argued that it is not clear whether parameters additional to those listed in the footnote might also be involved in examining the sectoral coverage of an agreement.

VI.3.2 Paragraph 1(b): Meaning of the «and/or» wording

95. 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

⁶⁰ It has been 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).

⁶¹ Discriminatory measures authorized are those imposed under Articles XI (Payments and Transfers), XII (Restrictions to Safeguard the Balance of Payments), XIV (General Exceptions) and XIV *bis* (Security Exceptions).

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». Different views co-exist on the interpretation of «and/or» wording:

- The «or» allows the parties to choose between provisions (i) and (ii), i.e. the elimination of existing discriminatory measures or alternatively the use of a standstill.
- 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 that level, (i) would be applicable and the applicability of (ii) would depend on the extent to which the discriminatory measures are eliminated under (i).
- Both (i) and (ii) are applicable, and that attention should be given to the paragraph 1(b) as a whole. 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.
- The «and/or» provision should be looked at 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.

VI.3.3 Paragraph 1(b): Definition of the «reasonable time-frame» provision

96. Regarding the time-frame itself, it could be interpreted to mean a ten-year limit (in parallel to the GATT Article XXIV:5(c), a five-year limit, or any time-frame limit to be applied on a case-by-case basis (rather than being formally defined).

97. A related issue has been whether a gradual and selected extension (i.e. to some sectors only) of certain key GATS obligations (such as national treatment) over time could be regarded as being in breach of both Articles V and XVII in terms of pace and coverage.

VI.3.4 Paragraph 2: Meaning of «a wider process of economic integration»

98. 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, which has raised two issues, namely the interpretation of «a wider process of economic integration» and the relationship between the compliance of an agreement with Article V and the existence of such a process.

99. It has been argued 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,⁶² as well as the integration of government regulatory measures (through harmonization or mutual recognition) among the parties.

100. In the presence of such a «wider process of economic integration», two views have been advanced as to its meaning in terms of RTA consistency assessment: either the threshold of permissible discriminatory measures could be lower, or the time-frame for a parallel liberalization of trade in goods could affect the «reasonable time-frame» for liberalization of trade in services.

⁶² That argument finds support in the drafting history of the paragraph.

VI.3.5 Paragraph 3: Scope of the flexibility allowed to agreements involving developing countries

101. Subparagraph V:3(a) allows «flexibility» to the parties to an agreement 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».

102. The main issue is whether such flexibility should be clearly defined. In particular, doubts remain on the following:

- whether the flexibility applies to both the requirements for «absence or elimination of substantially all discrimination» and for their elimination within a «reasonable time-frame»;
- whether the flexibility provided for meeting the requirements for «substantial sectoral coverage» under Article V:1(a) is limited by the emphasis on Article V:1(b) requirements, and if so, how much;
- whether, in the case of an agreement comprising both developed and developing country Members, flexibility would be extended to the services regimes of countries other than developing countries «in accordance with the level of development of the countries concerned».

103. Subparagraph 3(b) provides that, notwithstanding paragraph 6, in the case of an agreement 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.» It has been suggested that some limitations and/or conditions may be attached to that provision (e.g., by reserving more favourable treatment to enterprises that are not globally competitive). It has been noted that favourable treatment under Article V:3(b) should be interpreted in conjunction with Article V:3(a), which modulates the preferential treatment in accordance with the level of development of the countries and their competitiveness in trade in services.

VI.3.6 Paragraph 4: Methodology to assess an EIA's trade effects vis-à-vis third parties

104. Paragraph 4 stipulates that parties 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».

105. 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 trade data on services impede a significant evaluation of the level of barriers in effect before the establishment of the RTA.

106. 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, in practice, such an exercise would encounter significant data and methodological problems. Another approach would be to prevent any reduction of either the level, or growth, of trade in any sector or subsector below a historical trend.⁶³

⁶³ In cases where data on trade in services is unavailable the changes in the volume of trade could be measured by data on domestic economic activities. Otherwise, data from e.g. balance of payments, stocks of foreign direct investment and domestic industries could be used for purposes of evaluating the level of barriers.

107. The discussion on how greater economic integration among the parties could impact third party trade has drawn attention to one particular situation: 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. (see Section IV.2.4.)

108. Regarding the classification issue, the extension of an MFN exemption to an enlarged area has been viewed either as a simple change in the geographic scope of the exemption or, alternatively, as a new exemption. It has been argued that an exemption of an entirely different character to the original one had been created and that acceding parties remain Members of the WTO in their own right so that any changes to their schedules would count as a new measure. The classification of such measures as "new" or, alternatively, "unchanged" MFN exemptions would affect the legal procedures involved.

109. Regarding the trade effects of the extension of an MFN exemption, it has been suggested that it was irrelevant to address the question of whether overall barriers to trade had been raised as a result, given that such situation had to be dealt with under different legal provisions. Conversely, it has been argued that, as a first step, there was a need to examine whether barriers had been raised and, if so, an overall evaluation of the situation should be made.⁶⁴

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

- 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?

VI.3.7 Paragraph 6: Definition of «substantive business operations»

111. Paragraph 6 provides that a third-party service supplier, legally recognised as a juridical person by an RTA party, is entitled to equivalent treatment granted within the agreement, provided that it engages in «substantive business operations» in the territory of the parties to that agreement.⁶⁵

112. The main issue in this respect is the need to balance the requirements attached to «substantive business operations», so that they do not undermine the entitlement of third party suppliers to the same benefits as those of the parties while preventing the granting of equivalent treatment to non-established firms, or to firms which do not participate substantively in commercial transactions. 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). Disagreement subsists on whether third-party suppliers are entitled to a treatment equivalent to that granted to the parties in cases (i) where only a branch (instead of a head office) has been established in a party to the agreement, and (ii) where no, or only minimal, trade takes place with the other RTA partners.

⁶⁴ Namely, the negative effects of the extended MFN exemption 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.

⁶⁵ The concept of «substantive business operations» in services is equivalent to the rules of origin requirements in the goods area.

113. Doubts still remain on whether the term «substantive business operations» is meant to distinguish a service supplier producing services from one selling services; or 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 yet between service suppliers who may be "carrying on" a service (without being formally established) from those who are properly legally established.

VII. INTERACTION BETWEEN REGIONAL TRADE AGREEMENTS AND THE MULTILATERAL TRADING SYSTEM

VII.1. The building block/stumbling-block debate

114. In the traditional, conceptual debate on "regionalism vs. multilateralism", it has been argued that RTAs, by moving generally at a faster pace than the MTS and sharing its goals, represent a way of strengthening the latter.^{66,67} The positive effects of RTAs on the integration of developing countries in the world economy are also usually noted.

115. These views have been contested on the grounds of the fundamental changes observed in the geographical scale and trade-policy scope of the RTA process. It has been argued that the impact of these changes, coupled with the lack of flexible accession provisions in many RTAs hampers their effectiveness in contributing to the growth of world trade and the traditional synergies between the RTA and multilateral processes.

VII.2. Overlapping and networks of RTAs

116. It has been observed that overlapping RTA membership⁶⁸ impacts on trade and investment patterns; increases the complexity of RTAs, and magnifies negative effects on trade of complex and varying methods of determining regional content through preferential rules of origin. In addition, it has been argued that when diagonal cumulation is applied within a RTA network,⁶⁹ the preferential nature of any individual RTA is extended to parties to other RTAs, without any legal basis; 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.

117. Conversely, it has been argued that the constitution of RTA networks acts as a positive force for the multilateral system. Parties to individual RTAs within a network move toward the harmonization of rules of origin with the view to greater integration. Diagonal cumulation schemes under preferential rules of origin regimes reduce barriers and facilitate trade among participating economies, by simplifying and harmonizing customs procedures.

VII.3. Effects of the extension of trade policy areas regulated through RTAs

VII.3.1 Trade regulatory process

118. It has been argued that the current trend towards the creation of self-contained regional legal frameworks within RTAs is likely to lead to a progressive erosion of the multilateral legal framework.

⁶⁶ This view is expressed in *Regionalism and the World Trading System*, WTO Secretariat, 1995.

⁶⁷ A study by the WTO Secretariat 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 (*Inventory of Non-Tariff Provisions in Regional Trade Agreements*, WT/REG/W/26, para. 32).

⁶⁸ Membership to RTAs overlaps when individual countries participate in various distinct bilateral or plurilateral RTAs.

⁶⁹ RTA networks are clusters of RTAs, each with similar, if not identical, trade policy disciplines, developed in parallel.

While the impact of regional trade policy disciplines differing from those under the WTO Agreements is practically impossible to gauge, it has been observed that their development could lead to Members forgoing some of their WTO rights when becoming parties to an RTA. An example cited in this context is the fact that 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.

119. Conversely, the potential benefits to be gathered from the development and application of trade disciplines in individual RTAs or RTA networks have been highlighted, in particular their potential contribution to further multilateral liberalization.⁷⁰ There is wide recognition, however, 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,⁷¹ technical barriers to trade and sanitary and phytosanitary measures have been identified as areas to be considered in this respect, given the potential impact of such measures on third-party trade.

VII.3.2 Dispute settlement

120. Another area of growing concern refers to the effects of the dispute settlement provisions contained in "new generation" RTAs, which could build jurisprudence conflicting with that of the WTO. This issue has raised in particular with respect to RTA clauses providing that, in the event of inconsistency, RTA rules prevail over WTO rules. It has been argued that this could result in a diminution of the rights that the parties had under the WTO in relation to their trade with one another. It has however been noted that such situation was not contemplated in the language calling for RTA rules to prevail in the event of inconsistency; that language was geared toward situations in which the RTA provisions went beyond WTO disciplines.

121. Also, the argument that parallel dispute settlement procedures could nullify or impair WTO rights of third parties has been contested on the grounds that such procedures concerned trade between the parties and not trade with third parties.

⁷⁰ This reflects the "laboratory" role of RTAs.

⁷¹ For a review of contingency instruments as provided for in a number of RTAs, see WT/REG/W/26, Annex VI, paras. 39-53.

ANNEX

A Brief Account of GATT/WTO Rules and Procedures on RTAs

WTO provisions governing Members' participation in customs unions, free-trade areas (FTAs), and interim agreements are contained in paragraphs 4-11 of *GATT Article XXIV*. During the Uruguay Round, a number of provisions contained in the original Article XXIV, drafted in 1947, were clarified or interpreted, as contained in paragraphs 1-12 of the 1994 Understanding.

Rules with respect to reciprocal (tariff and non-tariff) preferential arrangements on trade in goods among developing countries are found in paragraphs 1, 2(c), 3(a & b) and 4 of the *Enabling Clause*.

GATS Article V lays down the rules governing economic integration agreements in the area of trade in services, including those implemented in stages.

Notification requirements

WTO Members are required to notify the RTAs they conclude:

«Any contracting party deciding to enter into a customs union or free-trade area, or an interim agreement ... shall promptly notify ...» [GATT Article XXIV:7(a)]

«Any contracting party taking action to introduce an arrangement ... shall: (a) notify ...» [Paragraph 4(a) of the Enabling Clause]

«Members which are parties to any agreement referred to in paragraph 1 shall promptly notify ...» [GATS Article V:7(a)]

Provision of information

Members are required to submit information on their agreements:

«Any contracting party deciding to enter into a customs union or free-trade area, or an interim agreement ... shall make available to [the CONTRACTING PARTIES] such information regarding the proposed union or area as will enable them to make such reports and recommendations to contracting parties as they may deem appropriate.» [GATT Article XXIV:7(a)]

«Any contracting party taking action to introduce an arrangement ... shall: (a) ... furnish [the CONTRACTING PARTIES] with all the information they may deem appropriate relating to such action.» [Paragraph 4(a) of the Enabling Clause]

«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.» [GATS Article V:7(a)]

These legal texts do not characterize what the information to be provided to the WTO by RTA participant Members should encompass.

Periodic reporting

Periodic reporting on the operation of customs unions and FTAs was introduced by the GATT Council in 1971. During several years thereafter, reports of varying comprehensiveness were submitted and considered by the Council, though generally not attracting much attention. The 1994 Understanding, in its paragraph 11, reiterated the obligation of providing such biennial reports.

However, no existing record details the objectives pursued in 1971, and no further explanation was provided in the 1994 Understanding.

Multilateral surveillance

RTAs notified to the WTO are subject to surveillance in various Bodies, at various levels of depth and complexity, depending upon which provision the notifying Member avails itself of:

- No GATT 1947 provision did textually refer to any kind of "examination" or "review" of notified RTAs. As noted above, Article XXIV:7(a) foresees that Members will need information «to make such reports and recommendations ... as they may deem appropriate», and requires RTA parties to make such information available to them. A practice has been developed of mandating a working party to «examine in the light of the relevant provisions of the GATT» each RTA notified under Article XXIV, and to «report thereon».⁷² In the WTO context, paragraph 7 of the 1994 Understanding clarified that all RTAs notified under GATT Article XXIV shall be «examined ... in light of the relevant provisions of GATT 1994 and paragraph 1 of this Understanding» and that a report shall be submitted to the CTG with «findings in this regard».⁷³ The 1994 Understanding also restated a neglected GATT procedure relating the periodic reporting on the operation of RTAs covered under Article XXIV.
- The Enabling Clause (paragraph 4(b)) envisions the possibility of bilateral or multilateral consultations in the case of RTAs among developing countries in the area of trade in goods.
- As to RTAs in the area of trade in services, the wording of GATS Article V:7(a) makes it clear that, whenever so decided by the Council for Trade in Services (CTS), an individual EIA will undergo examination with the aim «to report ... on its consistency» with GATS Article V.⁷⁴

RTA examination procedures under the GATT

For RTA seeking legal cover under Article XXIV of the GATT 1947, the process consisted of the following steps:

- The notification of an agreement (of which the text was also made available) was considered by the Council, which mandated the examination to a working party and invited contracting parties to ask written questions to the parties and these to reply to them, also in writing.
- Once a formal document was produced with all these questions and replies, the working party began its work.
- Working party meetings (usually with the participation of parties' experts from capitals) comprised a further exchange of questions and replies, political statements and legal comments. Sometimes, the parties submitted further information in writing (usually, statistics). This information was in some cases reproduced in a formal document.
- The working party's report on the examination, once agreed, was transmitted to the Council, for adoption.

⁷² This was the standard text in the terms of reference of GATT working parties.

⁷³ Today, similar language is found in the standard terms of reference for the examination of individual RTAs notified under GATT 1994.

⁷⁴ This is also reflected in the corresponding terms of reference for the examination.

The process was confidential, internal to the working party, except for the documents produced and the agreed report. There were no minutes of the debates. Interested contracting parties had to request membership in each working party; in general, only a few contracting parties (and usually the same) were active in RTA-related working parties.

Within those common procedures, each working party decided on its methods of work and these varied. The format of working party reports reflected those differences: some favoured a more descriptive approach of the work done, mixing factual information and judgments on consistency, while others had a more structured approach in line with Article XXIV provisions/requirements. Although, in most cases, working party conclusions merely recorded divergent views on the assessment of the RTA's full compatibility with the rules (usually by summarizing elements detailed in previous sections), these could take up a single paragraph or a whole section.

Current RTA examination procedures

Today, the process through which RTAs are dealt with after its notification and distribution of its text has changed, partly because of developments in WTO rules and partly as a consequence of the creation of the CRTA and the procedures developed therein:

- The notification of an agreement (together with its text) is considered by the CTG (if notified under GATT Article XXIV), the CTS (if notified under GATS Article V) or the Committee on Trade and Development, if notified under the Enabling Clause). If examination of the agreement is needed, the relevant body adopts the terms of reference for the examination and transfers the examination task to the CRTA.⁷⁵
- The parties to the RTA are invited to submit preliminary information on the agreement in the form of a Standard Format, which is published as a formal document. This is the initial step of what is called the "factual" examination.
- During (at least one or two) CRTA regular sessions, there is an exchange of oral questions and replies on the examined RTA, as well as more general statements by the parties and other Members. Detailed minutes are produced on each meeting devoted to the RTA examination, and published as formal documents.
- Between each of those meetings, usually a round of additional written questions and replies takes place. These are also published as a formal document.
- Once the CRTA feels that the factual part of the examination has concluded, the Secretariat is requested to draft a report on the examination, as the basis for consultations among Members (in open-ended informal CRTA meetings).
- The consensual CRTA report on a given agreement would then be sent to the WTO body which had mandated the examination, for adoption.

Information supplied by the parties, as well as questions and replies exchanged among Members in writing are issued as official, restricted WTO documents and, later, derestricted.⁷⁶ The same applies to proceedings of formal examination debates, where Members are identified in their interventions. The CRTA formal sessions are open to Members and observers, and consultations on draft reports are held as informal CRTA meetings (open to all Members).

⁷⁵ In the case of services agreements and those notified under the Enabling Clause, examination is not automatic but should be decided by Members. To date, decision to submit RTAs to examination was taken for all EIAs notified and already considered by the CTS, and for a single RTA notified under the Enabling Clause.

⁷⁶ The Standard Format is circulated as an unrestricted document.