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Committee on Regional Trade Agreements

SYSTEMIC ISSUES RELATED TO "SUBSTANTIALLY ALL THE TRADE"

Background Note by the Secretariat

Addendum

1. At the Thirteenth Session of the Committee on Regional Trade Agreements, the Secretariat was requested to prepare background documentation to assist the Committee in its consideration of systemic issues related to the concept of "substantially all the trade".
2. This note describes interpretative issues that have arisen in the GATT years in relation to the expression "substantially all the trade" as contained in Article XXIV of the GATT.
3. This note has been elaborated on the basis of the reports of the working parties that examined the following regional trade agreements (RTAs): Treaty of Rome establishing the European Economic Community (EC) (BISD 6S/70), Stockholm Convention establishing the European Free Trade Association (BISD 9S/70), EC-Israel Agreement (BISD 23S/55), Australia-Papua New Guinea Trade and Commercial Relations Agreement (BISD 24S/63), Australia-New Zealand Closer Economic Relations Trade Agreement (BISD 31S/170), Accessions of Portugal and Spain to the EC (BISD 35S/293), Canada-United States Free Trade Agreement (BISD 38S/47), European Free Trade Association-Turkey Free Trade Agreement (BISD 40S/48).
4. The issues highlighted below were, however, also addressed in a number of other working party reports.

LEGAL ELEMENTS IN THE GATT FRAMEWORK

5. According to GATT Article XXIV:8, a constitutive element for a customs union or a free-trade area is the elimination of duties and other restrictive regulations of commerce with respect to "substantially all the trade" among parties. Discussions in the GATT indicated that this concept has both a quantitative and a qualitative dimension. These are treated separately below.

Quantitative Aspects

6. The notion of a quantitative yardstick for determining that a regional trade agreement (RTA) had eliminated restrictions on "substantially all the trade" emerged in 1957, when the EC proposed, at the examination of the Treaty of Rome, that "a free-trade area should be considered as having been achieved for substantially all the trade when the volume of liberalized trade reached 80 per cent of total trade". Against this approach, it was argued that "each case of a proposed customs union or free-trade area had to be considered on its merits and that it was, therefore, inappropriate to fix a general

figure of the percentage of trade which could be subjected to internal barriers without running counter to the definition in paragraph 8(b) of Article XXIV ... [and that] any calculation of the percentage of trade not freed from barriers would need to take account of the fact that this would be, or would have been, larger if the trade had been allowed to flow freely".¹ The fixing of a general figure for "substantially all the trade" surfaced again only during the Uruguay Round negotiations.

7. A number of issues have been raised with respect to the measurement of the trade coverage of an RTA:

- (a) Free-trade areas in which some trade liberalization took place on a bilateral basis - at the time of the examination of the Stockholm Convention, some contracting parties were of the view that, because Article XXIV:8(b) provided for the elimination of restrictions on substantially all the trade "'between the constituent territories', trade covered by the bilateral agricultural agreements could only be included if the elimination of duties and other restrictive regulations of commerce was generalized to the trade of all the member States". The parties to the European Free Trade Association (EFTA), however, stated that, because the bilateral agricultural agreements "provided for the complete elimination of barriers for certain channels of trade, that trade should be included when estimating the total amount of trade freed from barriers", even though barriers were not removed by all the parties. They also contended that the drafting history of Article XXIV indicated that individual members of RTAs should have a certain latitude in respect of trade in some products and that this latitude was permitted by the "substantially all the trade" concept.²
- (b) Whether the percentage of the trade freed was to be expressed in relation to the trade of the parties with the world at large or only in relation to the trade among the parties themselves. At the time of the examination of the Stockholm Convention, while some contracting parties were of the view that the calculation should be based on the parties' trade with the world, EFTA States stated that "the trade between the member States generally was in fact representative of such trade. Moreover, the criterion in Article XXIV related to trade between the constituent territories."³
- (c) How to assess the trade coverage in RTAs of a non-reciprocal nature which generally involved contracting parties at different levels of economic development.⁴ For example, at the examination of the Australia-Papua New Guinea Agreement, the Australian argument, which was supported by some contracting parties, was not accepted by other contracting parties. It read as follows:

"[A]lthough Papua New Guinea would not be extending any reverse preferences to Australia under the Agreement, trade statistics showed that substantially all the trade was covered within the meaning of Article XXIV:8(b). It was pointed out in this connexion that Article XXIV did not contain any specific provision with respect to reverse preferences. The absence of reverse

¹BISD 6S/99-100, paragraphs 30 and 34.

²BISD 9S/84-85, paragraphs 50 and 51.

³*Ibid.*

⁴The conflicting views subsequently expressed with respect to the relationship between Article XXIV and Part IV of the GATT 1947 were inscribed in that same context.

preferences in favour of Australia did not, in the view of his authorities, affect the free-trade area status of the Agreement."⁵

- (d) Whether only the trade of products for which duties and other restrictive regulations of commerce had been eliminated should be taken into account or whether trade of products for which barriers had only been reduced should also be included.
- (e) RTAs involving a customs union on one side and a country (or group of countries) on the other side - whether the quantitative assessment of the trade conducted without restrictions should include or exclude trade within the customs union. However, the trade coverage of recent RTAs of this type has generally been presented excluding intra-trade.

Qualitative Aspects

8. At the examination of the of the Stockholm Convention, some contracting parties pointed out that the phrase "substantially all the trade" had not only a quantitative aspect but also a qualitative one, and that the exclusion of a major sector of economic activity should not be allowed, no matter what percentage of trade it covered. The EFTA States did not agree with the latter, pointing that "It was important to note that the phrase used in Article XXIV was 'substantially all the trade' and not 'trade in substantially all products.'" They argued further that:

"Insofar as it was relevant to consider the qualitative as well as the quantitative aspect, it would be appropriate to look at the consistency of the Convention with Article XXIV: 8 (b) from a broader point of view and to take account of the fact that the agricultural agreements did facilitate the expansion of trade in agricultural products even though some of the provisions did not require the elimination of the barriers to trade. Moreover, insofar as both qualitative and quantitative aspects were concerned it was incorrect to say that the agricultural sector was excluded from the free-trade area; in fact barriers would be removed on one third of total trade in agricultural products between member States. The figure of 90 per cent for the percentage of total trade between the member States to be freed from barriers was made up of 85 per cent in respect of trade on which barriers to imports into all member States were to be removed and 5 per cent in respect of which barriers to imports into certain member States were to be completely removed. There was a further area, in which the member States did not claim they were achieving free trade, but which was covered by the margin permitted by the phrase 'substantially all the trade'."⁶

9. A similar exchange of views took place during the examination of the EFTA-Turkey Agreement, where, according to the EFTA States:

"because the EFTA states had no common agricultural policy, trade in agricultural products was covered by separate bilateral arrangements [and] ... Together, the Agreement and the bilateral agricultural arrangements covered over 90 per cent of all trade between the EFTA

⁵BISD 24S/64-65 paragraphs 7 and 11.

⁶BISD 9S/83-85, paragraphs 48, 49 and 51. The full discussion of these arguments are recorded in paragraphs 47-56.

states and Turkey in 1991, thus fulfilling the requirement under Article XXIV:8(b) that duties and other restrictive regulations of commerce be eliminated on 'substantially all the trade'.⁷

10. Rejecting this interpretation, some other contracting parties pointed to the major significance of the agricultural sector to many countries and argued that "While Article XXIV:8(b) did not define 'substantially all the trade' to cover all existing trade between parties, it did not allow the exclusion of whole sectors from free-trade agreements." Further, the absence of "a common agricultural policy by the EFTA States could not be construed as permitting the automatic exclusion of the agriculture sector from free trade agreements concluded by them." Replying to these points, the representative of the EFTA States noted that "the agricultural sector did not represent a major trading sector in all countries ... [and] that views on what constituted a 'major sector' or 'substantially all the trade' to be covered by free trade agreements differed among contracting parties." Supporting the EFTA States, some contracting parties stated that "Article XXIV:8(b) required the obstacles to be eliminated 'on substantially all trade' and not 'on trade in substantially all products'" and that, in the light of the fact that it meant less than all trade, it "did not preclude the exclusion of a sector of economic activity provided that the overall trade coverage of the agreement met the criterion laid down in Article XXIV".⁸

11. The same type of arguments have been repeatedly put forward by delegations in the course of a great number of examinations.

Others

12. An added difficulty in determining whether an RTA fulfilled the "substantially all the trade" requirement resulted from the fact that, in many instances, contracting parties could not agree on whether a trade-restrictive measure applied between the parties was permitted under the exception list in Article XXIV:8. For example, in the examination of the Canada-United States Free Trade Agreement, where some contracting parties "raised doubts as to the consistency of the Agreement with the definition of a free-trade area in Article XXIV:8(b) and as to whether it covered 'substantially all' the trade between the parties. These members remained concerned about the exceptions allowing restrictions on trade between the two parties in a number of specific products."⁹

⁷BISD 40S/49, paragraph 6.

⁸BISD 40S/52-53, paragraphs 21-23.

⁹BISD 38S/73, paragraph 83.