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Committee on Regional Trade Agreements

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The following communication has been received from the Permanent Mission of Australia with the request that this document be distributed to all WTO Members.

Introduction

1. The Committee on Regional Trade Agreements (CRTA) has decided to examine the concepts of "substantially all trade" and "other regulations of commerce" as part of its work programme on systemic issues. Although both of these concepts are key components of GATT Article XXIV, there is no common interpretation among WTO Members of their meaning. This paper does not offer solutions. Rather, it is intended to be contribution towards the exploration of these concepts.

Substantially All Trade

2. GATT Article XXIV distinguishes between customs unions and free-trade areas, but the basic rules for them are largely the same. In both cases, parties to an arrangement must eliminate duties and other restrictive regulations of commerce, with stated exceptions, on substantially all the trade between the constituent territories in products originating in such territories.

3. All customs unions and free-trade areas notified under Article XXIV have to be examined against its provisions. Many GATT working parties, and now the CRTA, have devoted considerable time to the question of whether a notified arrangement covers substantially all the trade between its participants. The 1995 WTO study on Regionalism and the World Trading System notes that differences over the meaning of this expression have been a major reason why working parties have not reached a consensus on the GATT-consistency of individual agreements.

4. Sometimes there have been legitimate differences in the methodologies used, and it will not always be possible to eliminate these completely. It may, however, be possible to arrive within the CRTA at an understanding concerning the conditions under which an arrangement is thought to satisfy the criterion.

5. It is well understood that the fundamentally different approaches to the interpretation of "substantially all trade" have been the qualitative school (no exclusion of sectors, or at least not major sectors) and the quantitative school (a certain percentage of the trade between the participants must be covered).

6. It is worth recalling that when the difficulty of interpreting this concept arose in a serious manner for the first time in 1957 with the examination of the Treaty of Rome, the representative of the European Economic Community suggested 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.

7. The examination of the Stockholm Convention in 1960 gives another interesting illustration of this problem. As the Convention did not apply to trade in agricultural products, some members of the Working Party contended that this contravened the substantially-all-trade provision. The phrase had qualitative as well as quantitative aspects, and in this case, even if 90 per cent of the trade between the partners was covered, the percentage of trade covered could not be the only criterion.

8. A related issue is that we should not assume that liberalized trade is the same as free trade. On the contrary, liberalization is a process which creates freer trade, but which need not automatically result in free trade. Were, for example, an agreement for the creation of a customs union or a free-trade area list all sectors as being subject to liberalization, this would not necessarily imply that Article XXIV:8 has been satisfied.

9. Article XXIV permits phase-in arrangements. The Understanding on the Interpretation of Article XXIV now specifies that the reasonable length of time for interim arrangements should exceed 10 years only in exceptional cases. The question arising in this context is whether the provisions of Article XXIV:8, which refers to eliminated duties and other regulations of commerce, apply to the situation at the time the arrangement enters into force or the point where its parties consider that it has been implemented completely.

10. The CRTA might therefore consider what the respective advantages and disadvantages of the qualitative and quantitative approaches are. Some threshold questions in such a consideration could be the definition for the purposes of Article XXIV of a sector or a major sector, and what percentage figure could legitimately be considered to cover substantially all trade.

11. Both approaches have their advantages. That of the qualitative approach is that it leaves out no major sector. This is important particularly where a reduced amount of trade in a sector takes place because of other policies in place. The quantitative approach sets a benchmark which can be verified against the statistical evidence.

12. A successful solution to this problem probably will combine elements of both schools, provided one accepts that a certain level of discipline is desirable. But we do not underestimate the difficulties of reaching that point.

Other Regulations of Commerce

13. Article XXIV:8 provides for the elimination of duties and other restrictive regulations of commerce within free-trade areas or customs unions, with the exception, where necessary, of those permitted by Articles XI, XII, XIII, XIV, XV and XX. There has again been a great deal of debate over the question of whether this list of exceptions is complete, or whether it should be taken more in terms of an illustrative list.

14. The ambit of this provision is clearly confined to restrictive regulations of commerce. Regulations of commerce not deemed restrictive are not affected. It is usual for WTO Members to apply regulations of commerce to their import and export trade for which they charge a cost commensurate with the cost of providing a particular service. Such cost recovery probably should not be considered a restrictive regulation of commerce. The question then arises of what, in the context of the WTO system, should be considered a restrictive regulation of commerce.

15. It seems beyond doubt that the exceptions to the rule concerning the general elimination of quantitative restrictions listed in Article XI:2 can be employed in customs unions and free-trade areas provided that they are administered in accordance with Article XIII. Similarly, parties to such arrangements may have recourse to the restrictions to safeguard the balance of payments listed in Article XII, and they can use the rights available to them in relation to exchange controls under Articles XIV and XV. And they can invoke Article XX and its general exceptions. The mention of Article XIV is to some extent academic since it has not been used since 1961.

16. Delegations have in the past pointed out that Article XXI is not listed. In their view, if resort to general exceptions is permitted, there could hardly be a reason why security exceptions should be out of bounds. But there has always been a recognition that this Article applies to matters quite different to those listed in Article XX, and that no WTO Member will give up its right to judge when its essential security interests are involved. It would therefore be more profitable to consider the relevance of the list in Article XXIV:8 to other GATT articles.

17. Some have suggested that Article XIX should be part of the list also since the invocation of this Article produces an effect similar to an invocation of Articles XI and XII. Both will slow down the flow of imports. There is, however, an important difference in the motivation that lies behind Article XIX and the other articles.

18. Article XI declares quantitative import and export restrictions illegal, but it permits a range of strictly defined exceptions. Article XII permits the imposition of import restrictions for balance-of-payments reasons. Both of these articles deal in effect with situations that are external to the legal framework of the GATT.

19. Article XIX, on the other hand, allows for a derogation from Articles XI and II in the circumstances it describes. Without this Article, one could be in breach of one's obligations. In Article XIX, WTO Members have a mechanism to deal with developments that are a consequence of their liberalizing actions.

20. The question of phase-ins, already explored in paragraphs 8 and 9 above, also arises in a consideration of this concept. One might consider, for example, whether restrictive regulations of commerce should be eliminated immediately, or whether this could be done *pari passu* with the phasing out of duties.

21. By concluding a customs union or a free trade agreement, the parties in effect agree to a measure of economic integration that goes beyond that promoted by their normal international economic relations. They seek to achieve efficiencies in the internal market that they see as being out of reach for the time through other means. It seems odd, therefore, that they should use Article XIX against each other in order to prevent these efficiencies. There is of course the possibility that the partners might agree on a transition period during which safeguard action is possible. But once the arrangement is in full effect, unforeseen circumstances should no longer be a factor under a free trade agreement. Accordingly, the use of Article XIX would then be redundant.

22. A fully implemented customs union or free-trade area does not permit anything between free trade between the partners to the arrangement and MFN treatment for third countries. Taking again Article XIX as an example, a judgement would therefore have to be made whether, if there is no plan to eliminate safeguard action between the partners, the MFN rule would apply instead.

23. Similar observations could be made about Article VI and its application in a fully developed free-trade area or customs union.

24. A discussion of the meaning in terms of Article XIX of the expression "other regulations of commerce" therefore ought to cover not only the extent to which the list in Article XXIV:8 is comprehensive, but also how other regulations of commerce ought to be treated under an interim arrangement. In particular, discussion should cover the question of at what point a regulation is administered not under the MFN provisions, but under the rules of an arrangement fully compatible with Article XXIV.