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Committee on Regional Trade Agreements

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Addendum

At the meeting of the Committee on Regional Trade Agreements of 20 February 1998 a number of Committee Members commented on the ideas contained in an earlier Australian paper circulated as WT/REG/W/22. This paper seeks to reply to some of them. As in the earlier paper, the thoughts suggested here are at a conceptual stage. They will need to be examined against the practicalities of the negotiation and administration of regional trade agreements.

The proposal

1. Members will recall that the earlier Australian paper suggested that "substantially all trade" should be defined as coverage by a free-trade agreement or an agreement establishing a customs union of 95 per cent of all the six-digit tariff lines listed in the Harmonised System. This criterion would only apply to arrangements notified under GATT Article XXIV.

Responses to comments

What is the basis for selecting the figure of 95 per cent?

2. Article XXIV:8 states that duties and restrictive regulations of commerce have to be eliminated on *substantially* all the trade between the parties to an arrangement. We leave aside for the time being the question of how "other restrictive regulations of commerce" should be interpreted. As is also recognised in the paper by Hong Kong, China, (WT/REG/W/24) on the same topic, this clearly means less than all the trade between the parties. The criterion, expressed numerically, therefore has to be below 100 per cent. The proposed figure of 95 per cent is arbitrary. It is offered here for discussion purposes. The higher the figure is, the more it will contribute to trade liberalisation between the parties.

Would the figure of 95 per cent apply to the trade of all the parties to a regional trade agreement?

3. The figure of 95 per cent would apply to any arrangement regardless of the number of parties. Between them, the parties would be able to exempt 5 per cent of all six-digit tariff lines as listed in the Harmonised System (HS) from the requirement spelt out in GATT Article XXIV:8. How they would share out the 5 per cent would reflect the particular circumstances of the economies involved. The actual division of the available tariff lines would be done through negotiations between the prospective parties to the arrangement. In the same vein, if, for example, three economies were to participate, each would be entitled to a notional 1.66 per cent of exceptions.

What is the basis for suggesting that the Harmonised System be used?

4. The advantage of the HS is that it is recognised by all WTO members as the basis for regulating the conditions under which they conduct their trade in goods. It is a neutral system in that it covers trade in all goods, regardless of whether an economy actually imports or exports all of the products listed. The number of tariff lines down to the six-digit level is common to all who have accepted it. It would of course be quite feasible to use another internationally recognised system, such as the Standard International Trade Classification (SITC), which is used by many as the basis for their trade statistics.

Why has the six-digit level been chosen?

5. The HS classification is the same for all WTO members down to the six-digit level. At this level, it offers considerable disaggregation of tariff lines. Comparisons are therefore very easy. More detailed break-ups (e.g. eight or more digits) could be used, but these are specific to the special characteristics of the trade of a member. The element of ease of comparison could then be lost.

6. The aim of regional economic integration would be supported further if any sensitive products were identified as precisely as possible. The six-digit level promotes this idea. It also reflects a practice already followed by many parties to regional trade agreements (RTAs). RTA members would continue to have the option of splitting a six-digit tariff line to achieve the aim of precision.

7. The following illustration may help to make the point clearer. The parties to an RTA may have agreed to split a six-digit entry into three eight-digit ones. One of these would be free of duties and other charges in the sense of Article XXIV:8. The other two would represent sensitive products and continue to attract duties. In such a case, it would be appropriate to consider the two remaining eight-digit lines as a single six-digit tariff line in order to encourage as much liberalisation as possible.

When would the 95 per cent criterion apply?

8. The introduction of the 95 per cent criterion would have to be gradual. Presumably, it would apply when a new arrangement is notified. It would also apply when substantial changes to an existing arrangement are made, such as when a free-trade area is converted into a customs union. On the other hand, it probably would not be triggered for existing members when a new member joins an arrangement. There are never easy answers to this question, and the extent to which the criterion should apply to the joining member remains to be explored.

Is the proposed criterion enough to ensure compliance with Article XXIV:8?

9. Some CRTA Members have pointed out that it in some cases trade may be concentrated in relatively few products. The effect of this could be that the 95-per-cent criterion would permit, for all practical purposes, the exemption of sizeable trade flows. They have therefore suggested that this criterion should be accompanied by another one which would prevent this possibility. This is to some extent a restatement of the controversy whether a "quantitative" or a "qualitative" criterion, or both, should be adopted.

10. One possible solution to this problem would be the introduction of an assessment of prospective trade flows under an arrangement at various stages. These stages could be (a) entry into force, (b) after five years and (c) full implementation, assuming that the parties have availed themselves of the possibility of the maximum phase-in period for an interim arrangement.

11. In paragraph 2 of the Understanding on Article XXIV, WTO Members have agreed to an evaluation by the WTO Secretariat of the incidence of tariff rates and customs duties. It might be possible to arrive at a similar evaluation in respect of trade covered under an RTA. Such an evaluation would have to be based on an agreed method which would yet have to be developed. The text of the RTA usually contains clear guidance concerning coverage and any phase-in arrangements. In practice, it might lead to the following hypothetical result:

Free-trade Agreement between Customs Territory A and Customs Territory B

Assessment of amount of trade covered

Entry into force > 90%	After 5 years > 95%	After 10 years	100%
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Assessment of HS 6-digit lines covered

Entry into force > 95%	After 5 years > 98%	After 10 years	100%
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Any result of this nature would indicate clearly that a genuine free-trade arrangement is contemplated. Accordingly, an examination and an assessment of its conformity with Article XXIV should pose few difficulty.

12. On the other hand, it is possible a preliminary evaluation would show the following result:

Free-trade Agreement between Customs Territory C and Customs Territory D

Assessment of amount of trade covered

Entry into force > 65%	After 5 years > 75%	After 10 years	< 85%
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Assessment of HS 6-digit lines covered

Entry into force > 95%	After 5 years > 97%	After 10 years	< 100%
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Such an outcome would show clearly that although the HS-criterion is satisfied at the time of entry into force of the agreement as well as during much of the implementation period, the specific composition of the trade between the parties leads to less liberalisation than would be desirable.
