CHAPTER 16

REGIONAL INTEGRATION

A. OVERVIEW OF RULES

1. BACKGROUND OF RULES

The multilateral framework based on the GATT/WTO and IMF systems has sustained the world economy since World War II. In both developed and developing countries, the amount of trade covered by regional trade agreements (RTAs) has increased and expanded since the 1990s. Today, regional trade within regionally integrated areas accounts for a considerable share of world trade (*see* Figures II-16-1 and II-16-2). In the European Union, 63.3% of the gross value of exports from EU member states is to other EU member states; 63.6% of the gross value of their imports is from other EU member states. A similar situation exists with regard to NAFTA, with 50.2% of the gross value of their exports going to other NAFTA member countries.

Figure II-16-1 Share of Major RTAs in the Value of World Trade (Trade in Goods)

	Export				Import			
	Amount (2014)		Increase Ratio (%)		Amount (2014)		Increase Ratio (%)	
	(Billion $US)	Share (%)	2014	10-14	(Billion $US)	Share (%)	2014	10-14
World	184,94	100.0	0	6	186,41	100.0	1	5
North America	24,93	13.5	3	6	32,99	17.7	3	5
The US	16,21	8.8	3	6	24,05	12.9	4	5
South and Central America	6,95	3.8	-6	4	7,46	4.0	-5	6
Europe	68,11	36.8	0	5	67,85	36.4	1	4
CIS	7,35	4.0	-6	6	5,03	2.7	-11	5
Africa	5,55	3.0	-8	2	6,34	3.4	1	8
Middle East	12,88	7.0	-4	9	7,83	4.2	0	8
Asia	59,17	32.0	2	6	58,72	31.5	0	7
Japan	6,84	3.7	-4	-3	8,20	4.4	-1	4
China	23,42	12.7	6	10	19,57	10.5	0	9
EU	61,62	33.3	1	5	61,33	32.9	2	3
NAFTA	24,93	13.5	3	6	32,99	17.7	3	5
MERCOSUR	3,16	1.7	-8	4	3,28	1.8	-6	6
ASEAN	12,95	7.0	2	6	12,35	6.6	-1	7

Source: WTO Annual Report 2015 International Trade Statistics (by the WTO Secretariat)

Note: Increase Ratio of 2014 is in comparison with year 2013.

Figure II-16-2 Ratio of Intra and Extra Trade among Major RTAs (Trade in Goods)

	Export (2014)					Import (2014)				
	Total Amount*1	Internal (%)		External (%)		Total Amount*1	Internal (%)		External (%)	
		S*2	IR*3	S*2	IR*3		S*2	IR*3	S*2	IR*3
EU	61,62	63.3	3	36.7	-2	61,33	63.6	3	36.4	0
NAFTA	24,93	50.2	5	49.8	1	32,99	34.8	5	65.2	3
MERCOSUR	3,16	13.9	-14	86.1	-7	3,28	13.0	-12	87.0	-5
ASEAN	12,95	25.5	0	74.5	2	12,35	22.5	-1	77.5	-1

Source: WTO Annual Report 2015 International Trade Statistics (by the WTO Secretariat)

Notes: *1-$US, in billions

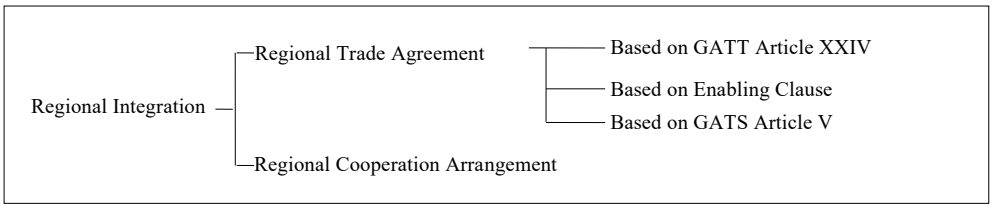
*2-S: Share (Year 2014)

*3-IR: Increase Ratio 2014 (In comparison with year 2013)

Under the WTO Agreement, Regional Trade Agreements are divided into those involving the trade of goods, based on GATT Article XXIV, those involving trade with developing countries based on the “Enabling Clause” (See Chapter 1 “Most-Favoured-Nation Treatment”, Part II) agreed by contracting parties in 1979, and those involving the trade in services, based on GATS Article V. GATT Article XXIV defines three basic regional trade agreement categories: “customs union (CU)”, “free trade area (FTA)”, and the “interim agreement” leading to the CU and FTA (*see* Figure II-16-3 for a detailed overview). When comparing a Customs Union (CU) and a Free Trade Area (FTA), the similarity is that both seek to liberalize trade within contracting regions by eliminating tariffs and restrictive trade rules (*see* Figure II-16-10 for a detailed overview). The difference between them is that under a CU, external uniform tariff rates are applied in order to make all tariff rates and trade rules for goods traded among the contracting parties effectively equal. However, since only the export and import between contracting countries become the subjects of liberalization, there is no need to make tariffs uniform under an FTA.

Furthermore, "regional integration" is structured by the provisions of regional trade agreements that are allowed as exceptions under the WTO and regional cooperation arrangements like Asia Pacific Economic Cooperation (APEC). The structure diagram is shown below. This chapter will mainly explain the provisions of regional trade agreements that are allowed as exceptions under the WTO.

Article XXIV of the GATT exempts RTAs from the MFN principle under certain conditions. Specifically, RTAs must not raise barriers to trade with countries outside of the region and must eliminate barriers to trade within the region with respect to substantially all the trade. The reason for this condition is that, while RTAs promote trade liberalization within the respective regions, if they raise barriers to trade with countries outside the regions, they would impede trade liberalization as a whole. From this standpoint, Article XXIV must be applied judiciously lest the WTO is turned into an empty shell.



2. LEGAL FRAMEWORK

1) EXISTING GATT/WTO PROVISIONS ON RTAS

Tariff reductions applying exclusively to specific countries are prohibited in principle under Article I of the GATT, which requires MFN treatment as a basic rule.

The WTO, however, under Article XXIV of the GATT, authorizes the establishment of CUs, FTAs and interim agreements if their purpose is to facilitate trade within the region and not to raise barriers to trade with non-parties. The WTO allows these RTAs to be exempted from the MFN principle as long as they conform to the conditions outlined in Figure II-16-3, below.

Figure II-16-3 Conditions of Customs Unions, FTAs and Interim Agreements

Under Article XXIV of the GATT

Conditions Under Articles XXIV:5 and 8 of the GATT

	Article XXIV:5	Article XXIV:8
Customs Unions (CUs)	(a) For external countries, whether or not the tariffs and other regulations of commerce are higher than the averages of those used before forming the Customs Union or more restrictive than the general incidence of those previously applicable in the constituent territories prior to the formation.	(a)(i) The duties and ORRCs** (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated with respect to "substantially all the trade" between the constituent territories of the union, and, (ii) Substantially the same duties and ORCs* are applied by each of the members of the union to the trade of territories not included in the union.
Free Trade Areas (FTAs)	(b) The duties and ORCs* to the trade of contracting parties not included in such area shall not be higher or more restrictive than those previously existing in the same constituent territories prior to the formation.	(b) The duties and ORRCs** (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV, and XX) are eliminated with respect to "substantially all the trade" between the constituent territories.
Interim Agreements	in addition to (a) or (b) above -- (c) Any interim agreement shall include a plan and schedule for the formation of such a customs union or FTA within a reasonable length of time.	

*ORCs (other regulations of commerce)
*ORRCs (other restrictive regulations of commerce)
(Compensatory adjustment under Article XXIV:6)

- With respect to a Customs Union, in fulfilling the requirements of Article XXIV:5(a), when a contracting party proposes to increase any rate of duty inconsistent with the Article II, the procedures set forth in Article XXVIII shall apply for compensatory adjustment.

(Notification to the Contracting Parties and Consideration)

- Any contracting party deciding to enter into a customs union or FTA or an interim agreement, shall promptly notify the WTO (Article XXIV:7(a)).
- After notification, the contracting parties will discuss and review the plans and schedules in the interim agreement with the parties to the agreement; the Contracting Parties shall make recommendations where appropriate (Article XXIV: 7(b)).

Before the establishment of the WTO, each notified RTA had been examined to determine whether it is consistent with Article XXIV of the GATT by working parties established separately for that RTA. However, there is almost always disagreement over how to interpret Article XXIV since the wording is vague: "substantially all the trade between the constituent territories," "other restrictive regulations of commerce (ORRCs)," "on the whole ... shall not be higher or more restrictive." All of the working party reports contain descriptions of the pros and cons.

Interpretation of Article XXIV became an issue in the review of the Treaty of Rome that established the European Economic Community (EEC) signed in 1957 and only six of the 69 working parties that had completed reviews by the end of 1994 had been able to reach a consensus on conformity questions. But while differences of opinion on Article XXIV interpretation exist in almost every review of RTAs, the legitimacy of preferential treatment for an RTA has only been contested in three panel cases. The GATT Council did not adopt any of these panel reports. Three Appellate Body reports covering RTAs have been issued since the establishment of the WTO, but these do not include explicit determinations regarding core issues of Article XXIV. Clarification of the implementation of Article XXIV is still necessary.

During the Uruguay Round negotiations, members discussed how to remove the ambiguity that had made interpretation of Article XXIV difficult. This led to the "Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade," which contains an explicit requirement to calculate "the general incidence of the duties" stipulated in Article XXIV: 5(a) with an average weighted-for-trade volume rather than the arithmetical average used by the EU. There was also a proposal to prohibit excluding major goods because of "the substantially all the trade between the constituent territories" clause in Article XXIV: 8, but no consensus could be reached on this issue. Instead, as shown in Figure II-16-4, limited improvements were made. For the trade in services area, countries agreed to add language to Article V of the GATS similar to Article XXIV of the GATT (*see* Figure II-16-5).

Figure II-16-4 New Rules for Clarification of Article XXIV of the GATT

(a) Understanding on the Interpretation of Article XXIV of the GATT 1994

- The "general incidence of duties and other regulations of commerce" of the Customs Union referred to in Article XXIV: 5(a) shall, with respect to duties and charges, be based upon an overall assessment of weighted average tariff rates and of customs duties collected (paragraph 2).

- The “reasonable length of time” in Interim Agreements referred to in Article XXIV: 5(c) until the formation of a custom union should generally not exceed 10 years (paragraph 3).
- When a Member forming a customs union proposes to increase a bound rate of duty, the procedure set forth in GATT XXVIII (procedure to revise Schedule of Concession) must be commenced before tariff concessions are modified or withdrawn (paragraph 4).
- Members benefiting from a reduction of duties as a result of the formation of a customs union or an interim agreement are not obligated to provide compensatory adjustment (so-called "reverse compensation") to the constituents of such an agreement (paragraph 6).
- The Council of Trade in Goods may issue appropriate recommendations based on Working Party Fact Recognition Reports regarding the creation of a regional union or the addition of new Members (paragraph 7).

(b) Anti-Dumping Agreement (Article 4.3)

- Where two or more countries have attained under the provisions of Article XXIV:8(a) of the GATT 1994 (customs unions), such a level of integration that they have the characteristics of a single, unified market, the industry in the entire area of integration shall be considered the domestic industry for purposes of antidumping measures when applying Antidumping Agreement.

(c) Subsidies Agreement (Article 16.4)

- Same provisions as in the Antidumping Agreement.

(d) Agreement on Safeguards (Article 2.1, footnote)

- Nothing in this Agreement prejudges interpretation of the relationship between Article XIX and Article XXIV: 8 of GATT 1994.

(e) Agreement on Rules of Origin (Annex II)

- With respect to preferential tariffs in RTAs, as well as common preferential tariffs, a Member must ensure that:
- Administrative determinations of general application clearly set out the requirements to be fulfilled in order to meet the preferential rule of origin (Paragraph 3(a)).
- Preferential rules of origin are based on a positive standard (Paragraph 3(b)).
- All laws, regulations and determinations relating to preferential rules of origin are published in accordance with the provisions of Article X: 1 of GATT 1994 (Paragraph 3(c)).
- When introducing changes to the preferential rules of origin or new preferential rules of origin, they are not applied retroactively (Paragraph 3(e)).

Figure II-16-5 General Agreement on Trade in Services, Article V (Economic Integration)

Economic integration of the service sector is subject to the regulations of Article V of GATS and the following three conditions are especially important. (*see* note below)

(1) Substantial sectoral coverage (GATS Article V.1(a))

(2) No provisions for the *a priori* exclusion of any mode of supply (footnote to GATS Article V.1(a))

(3) The elimination of substantially all discrimination within a reasonable time frame (GATS

Article V.1(b))

There is no clear definition of either the content of the "substantial sectoral coverage" in (1) above or the duration of a "reasonable time frame" in (3) above. It is hoped this matter will be debated.

As an exception for developing countries, a regulation exists to apply the above conditions in accordance with the level of development of concerned countries (GATS Article V: 3(a)). In addition, there is a regulation stating that in 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" (GATS Article V.3(b)). This is an exception to the GATS Article V.6 regulation that "a service supplier of any other Member that is a juridical person […] shall be entitled to treatment granted under such agreement, provided that it engages in substantive business operations in the territory of the parties to such agreement." It is said this exception was made during the Uruguay Round in order to allow for the continuation of MERCOSUR.

In evaluating condition (3) above (the elimination of substantially all discrimination), GATS Article V.2 states that, regarding an agreement liberalizing trade in services, "consideration may be given to the relationship of the agreement to a wider process of economic integration or trade liberalization among the countries concerned." This regulation works to mitigate conditions for the liberalization of services when liberalizing goods with a FTA. The WTO Committee on Regional Trade Agreements (CRTA) is responsible for examining the liberalization of goods and service sectors.

NOTE: The following are additional conditions for service regional trade agreements:

- The general level of barriers to trade in services within the respective sectors for Members outside the agreement shall not be raised beyond levels prior to enactment of the applicable agreement. (GATS Article V.4)
- Reverse compensation may not be sought (GATS Article V.8)

(*See* "Services," Chapter 2, Part III of this Report for a schedule of commitments)

The Ministerial Declaration adopted by the Doha Ministerial in November 2001 noted Members' agreement to negotiations aimed at clarifying and improving disciplines and procedures under the existing WTO provisions applying to RTAs. Negotiations are ongoing. Consensus was reached on procedural clarification, and on 14 December 2006 the WTO General Council adopted a Transparency Mechanism for regional trade agreements (*see* 3(b) below for details). This is being provisionally applied as an "early harvest" stipulated by Paragraph 47 of the Doha Ministerial Declaration. The operation of the system was supposed to be reviewed in one year from the beginning of operation so as to establish a permanent mechanism, but the results are incomplete; as of February 2016 the review had not been undertaken. Future negotiations will include debate on the clarification of levels of liberalization that should be achieved by regional trade agreements.

Japan's first EPA was the Japan-Singapore EPA, which took effect in November 2002. Initially, the EPA will eliminate tariffs for 100% of the value of Japanese exports to Singapore, approximately 94% of the value of Japanese imports from Singapore, and approximately 98% of the total trade value between the parties over a period of 10 years. As a result of renegotiations starting in June 2006, Japan agreed in January 2007 to expand the areas eligible for tariff elimination to include certain petroleum/petrochemical products and certain tropical products. In

turn, Singapore pledged to improve its specific commitments for financial services.

The levels of liberalization achieved by Japan's Economic Partnership Agreements (EPA) are detailed below (*see* Figure II-16-6).

Figure II-16-6 Levels of Liberalization under Japan's Economic Partnership Agreements Which Have Been Signed or Have Entered in Force[*1]

Counter Party	Year came into effect	Rate of Liberalization within 10 years (Trade value basis)			
		Japan (%)	Counterparty (%)	Total Trade (%)	(Data used for Calculation)
Singapore	November 2002	94.7	100	Approx. 99	2005
Mexico	April 2005	86.8	98.4	Approx. 96	2002
Malaysia	July 2006	94.1	99.3	Approx. 97	2004 (Japan), 2003 (Malaysia)
Chile	September 2007	90.5	99.8	Approx. 92	2005
Thailand	November 2007	91.6	97.4	Approx. 95	2004 (Japan) 2003 (Thailand)
Philippines	December 2008	91.6	96.6	Approx. 94	2003
Brunei	July 2008	99.99	99.9	Approx. 99.9	2005
Indonesia	July 2008	93.2	89.7[*2]	Approx. 92	May 2004 - April 2005
ASEAN	December 2008	93.2	Approx. 91	-	2006 (Japan), 2005 or 2006 (ASEAN)
Switzerland	September 2009	99.3	99.7	Approx. 99	2006
Viet Nam	October 2009	94.9	87.7	Approx. 92	2006
India	August 2012	97.5	90.3	Approx. 94	2006
Peru	March 2012	99.7	99.9	Approx. 99.8	2008
Australia	January 2015	93.7	99.8	Approx. 95	2013
Mongolia	Not yet effective	100	96.0	Approx. 96	2012

*1 Signed agreements are limited to those that have been approved by the Japan's Diet.

*2 Approximately 96% when including the tariff elimination corresponding to the user specific duty free scheme of steel

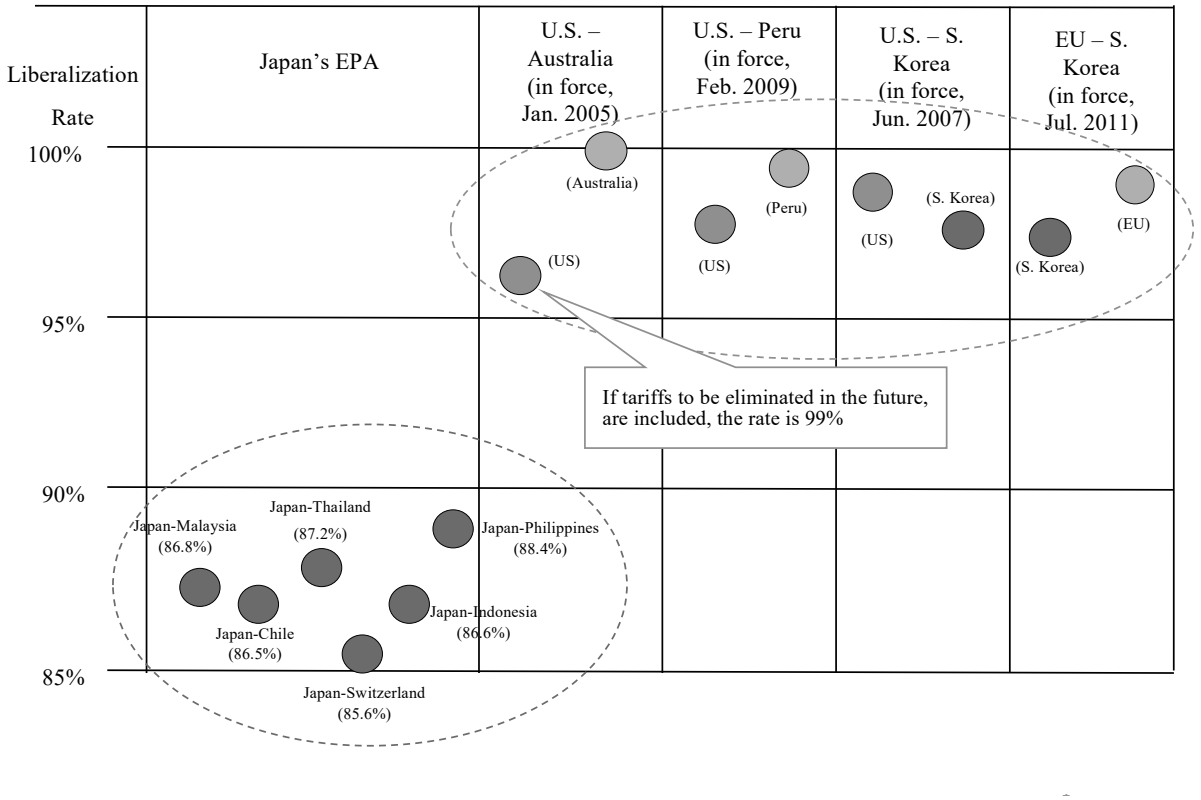
The Japan - Australia EPA became effective in January 2015. Within 10 years of the Agreement taking effect, it will eliminate tariffs for approximately 99% of the value of Japanese exports to Australia (based on the amount of trade in 2013), and approximately 94% of the value of Japanese imports from Australia, equating to approximately 95% of the total trade value of the parties. The Japan- Mongolia EPA was signed in February 2015. Within 10 years of the Agreement taking effect,

it will eliminate tariffs for approximately 96% of the value of Japanese exports to Mongolia (based on the amount of trade in 2012), and 100% of the value of Japanese imports from Mongolia, equating to approximately 96% of the total trade value of the parties.

As is evident in the above paragraphs, Japan's Economic Partnership Agreements provide for greater than 90% level of liberalization for trade value to be achieved within 10 years.

Furthermore, if the liberalization rate is looked at on a tariff line basis, the liberalization rates of US/EU EPAs/FTAs are high compared to those of Japan's (*see* Figure II-16-7).

Figure II-16-7 Liberalization rate comparison between Japan's EPA and FTAs of the US/EU (tariff line basis)



Note: This chart presents item-based liberalization rates (the percentage of items out of all items) in which tariff abolition will be carried out within 10 years

Resource: Cabinet Secretariat -- document distributed in connection with "Thinking about TPP Together: A Regional Symposium"

The tariff elimination rates of individual EPA/FTA in other countries (including, in part, tariff elimination rates of EPAs between developing countries) are provided below, based on reports of regional trade agreements produced by the WTO Committee on Regional Trade Agreements (CRTA) (*see* Figure II-16-8)).

Figure II-16-8 Levels of Liberalization under Regional Trade Agreements between Third Parties (based on the Factual Presentations compiled by the WTO Secretariat)

Agreement	Effective Date	Liberalization Rate (%) (Trade Value Basis)[1)]		Elimination Period
Republic of Korea-Chile	Apr. 2004	Republic of Korea	99.9	2020
		Chile	96.2	2017
US-Australia	Jan. 2005	US	98.8	2023
		Australia	100	2015
Thailand-Australia	Jan. 2005	Thailand	100	2025
		Australia	100	2015
India-Singapore	Aug. 2005	India	75.3	2009
		Singapore	100	2006
Republic of Korea-Singapore	Mar. 2006	Republic of Korea	90.8	2016
		Singapore	100	2006
Trans-Pacific Strategic Economic Partnership Agreement (P4)	May 2006[2)]	Brunei	99.3	2015
		Chile	100	2017
		New Zealand	100	2015
		Singapore	100	2006
Chile-China	Oct. 2006	Chile	96.9	2015
		China	99.1	2015
Egypt-Turkey	Mar. 2007	Egypt	95.0	2020
		Turkey	83.7	2007
Pakistan-China	July 2007	Pakistan	44.4	2010
		China	30.3	2010
China-New Zealand	Oct. 2008	China	88.0	2019
		New Zealand	100	2016
US-Peru	Feb. 2009	US	100	2025
		Peru	100	2025
Peru-China	Mar. 2010	Peru	91.1	2026
		China	99.1	2026
EU-Republic of Korea	July 2011	EU	99.9	2031
		Republic of Korea	99.9	2031
Peru-Republic of Korea	Aug. 201	Peru	100	2027
		Republic of Korea	100	2026
US-Republic of Korea	Mar. 2012	US	100	2026
		Republic of Korea	98.9	2031
Australia-Malaysia	Jan. 2013	Australia	100	2013
		Malaysia	99.0	2026
Republic of Korea-Turkey	May 2013	Republic of Korea	99.3	2023
		Turkey	99.9	2023
China-Switzerland	July 2014	China	88.7	2028

		Switzerland	99.8	2014
Australia-Republic of Korea	Dec. 2014	Australia	100	2021
		Republic of Korea	95.2	2033

1) Date of trade data (standard year) used for calculation of liberalization rate varies depending on date of signing of agreement.
2) Brunei came into effect in July 2006, Chile in November 2006

Source: Based on Factual Presentations compiled by the WTO Secretariat

For U.S.-ratified FTAs, tariffs will be eliminated for 99% of the value of intra-area trade in NAFTA (implemented in 1994) within 10 years of the agreements taking effect. In the United States-Australia FTA (implemented in 2005), Australia agreed to eliminate tariffs for all items, while the US established some categories for agricultural and fishery products to be excluded, making the tariff elimination rate for all categories approximately 98% on a tariff line basis. In the United States-Korea FTA (implemented in 2012), the tariffs for all categories, approximately 99% on a tariff line basis, will be eliminated within 10 years.

In the Canada-Chile FTA (implemented in 1997), the tariffs for 100% of the value of Canadian imports from Chile, 88.5% of Chilean imports from Canada, and 93.4% of the total trade value between the parties will be eliminated within 10 years of the Agreement taking effect. The rate of Chilean tariff elimination is low; however, the period for tariff elimination is longer than 10 years (up to 18 years). The rate of Chilean tariff elimination reaches 99.5% when these longer elimination period items are taken into account. In the Korea -Chile FTA (implemented in 2004), the tariffs for 77.3% of the value of Chilean imports from Republic of Korea and 99.9% of the value of Korean imports from Chile will be eliminated within 10 years of the Agreement taking effect. Chile's rate of tariff elimination is low in this case as well, but reaches 96.2% if 13-year-elimination items are taken into account.

MERCOSUR (implemented in 1995) is a trade union based on the Enabling Clause and consists of six countries -- Argentina, Bolivia, Brazil, Paraguay, Uruguay and Venezuela. Although in principle MERCOSUR eliminates intra-regional tariffs, individual countries have excluded items such as sugar. Approximately 95% of the trade value of the MERCOSUR was eliminated.

The Southern African Development Community (SADC) (implemented in 2000) is an FTA which consists of 13 countries in Southern Africa. Approximately 91% of the trade value of the countries in the area was eliminated by 2015 (excluding Angola and the Democratic Republic of Congo).

In Europe, the EU (implemented in 1968) committed to tariff elimination for all items. In the EU-Mexico FTA (implemented in 2000) and the EU-Chile FTA (implemented in 2003), 97.1% of the value of the trade within the area will be eliminated within 10 years of the Agreements taking effect. In addition, in EU-Korea FTA (implemented in 2011), the tariffs for 99.8 of the total trade value between the parties will be eliminated within 10 years of the Agreement taking effect.

In Asia, based on the Common Effectiveness Preferential Tariff (CEPT) Agreement for AFTA (ASEAN Free Trade Area) (effective 1992), in January 2010, the ASEAN member countries (Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand) eliminated tariffs on 99.65% of the items on a tariff line basis. The new member countries of CLMV (Cambodia, Laos, Myanmar and Viet Nam) eliminated tariffs on 98.96% of all items. In May 2010, the ASEAN Trade in Goods Agreement (ATIGA) came into effect as a document consolidating all the past decisions taken by ASEAN (except for the CEPT Agreement).

In the China-ASEAN FTA (implemented in 2003), there are sensitive track items where the final tariff rate is to be reduced to 0%-50%. China and original ASEAN member countries have a limit of sensitive track items of less than 400 items on HS 6-digit tariff line basis and less than 10% on trade-value basis, while CLMV have a limit of 500 items on HS 6-digit tariff line basis. Subtracting these amounts yields a final tariff elimination of at least more than 90% on tariff line basis.

In the Korea-ASEAN FTA (implemented in 2007, excluding Thailand), there are sensitive items subject to tariff reduction or maintenance of the existing tariff rate. Republic of Korea and original ASEAN member countries have a limit of sensitive items of less than 10% on both a trade value and tariff line basis. CLMV have a limit of sensitive items of less than 10% on tariff line basis, while Viet Nam has a limit of sensitive items of less than 25% on a trade value basis, as well. Subtracting these amounts yields a final tariff elimination of at the very least more than 90% on a tariff line basis.

The Australia-New Zealand Closer Economic Relations Trade Agreement (implemented in 1983) and the Agreement between New Zealand and Singapore on a Closer Economic Partnership (implemented in 2001) both pledge to eliminate all tariffs within 10 years. In the Australia-Thailand FTA (implemented in 2005), the tariffs for 100% of Australian imports from Thailand and 99% of the value of Thailand's imports (99% of products) from Australia were eliminated within 10 years of the Agreement taking effect (to rise to 100% within 20 years of the Agreement taking effect). In the New Zealand-Thailand FTA (implemented in 2005), the tariffs for 100% of the value of New Zealand's imports from Thailand and 70% of the value of Thailand's imports (99% of products) from New Zealand were eliminated within 10 years of the Agreement taking effect (100% of Thailand's imports from New Zealand within 20 years of the Agreement taking effect). Both Australia and New Zealand have achieved the 100% tariff elimination rate. In the Australia-Korea FTA (implemented in 2014), the tariffs on 95.2% of the value of Korean imports from Australia and 100% of the value of Australian imports from the Republic of Korea will be eliminated within 10 years of the Agreement taking effect (at least 99% of the value of Korean imports from Australia within 20 years of the Agreement taking effect). In the Australia-China FTA (implemented in 2015), the tariffs for about 86% of the value of China's imports from Australia were eliminated at the time the Agreement took effect, the tariffs for about 94% of such value will be eliminated by January 2019, and the tariffs for about 96% of such value will be eliminated within 15 years of the Agreement taking effect. The tariffs for 100% of the value of Australia's imports from China will be eliminated within 10 years of the Agreement taking effect.

2) TREATMENT OF RTAS AMONG DEVELOPING COUNTRIES

To address RTAs among developing countries, the GATT contracting parties on November 28, 1979 agreed on "Differential and More Favourable Treatment Reciprocity and Fuller Participation of Developing Countries" (hereinafter "Enabling Clause". The decision serves as the basis for special treatment accorded to developing countries in matters of trade. This became part of the 1994 GATT. The Enabling Clause exempts RTAs entered into among developing countries for the mutual reduction or elimination of tariffs and non-tariff measures from the MFN principle under Article I of GATT (paragraph 2(c)), provided the following conditions detailed in Figure II-16-9, below are met.

There are three different views on interpreting the relationship between Article XXIV of the GATT and the RTAs among developing countries established on the ground of the Enabling Clause. It is not clear which view should prevail:

(a) The Enabling Clause was enacted so that developing countries could increase their exports and

further expand their economies. RTAs between developing countries should therefore be looked at only under the terms of the Enabling Clause.

(b) The Enabling Clause only imposes certain requirements on contracting parties to notify and consult countries that are entering into agreements or taking measures that are by their nature partial and non-inclusive. It is therefore not sufficient as a basis for dealing with RTAs. This must be done under Article XXIV.

(c) Judgments concerning RTAs among developing countries should take into account both Article XXIV and the Enabling Clause.

Figure II-16-9 Conditions of the Enabling Clause

Conditions

- Regional arrangements shall be designed to facilitate and promote the trade of developing countries and not raise barriers to or create undue difficulties for the trade of any other contracting parties (paragraph 3(a)).
- RTAs should not constitute an impediment to the reduction or elimination of tariffs and other restrictions to trade on a most-favored-nation basis (paragraph 3(b)).

Notification to the contracting parties and consultations

- Parties to such regional arrangements shall notify the contracting parties and furnish them with all the information they may deem appropriate to such action (paragraph 4(a)).
- They should afford adequate opportunity for prompt consultations at the request of any interested contracting party (paragraph 4(b)).

Therefore, RTAs notified based on the Enabling Clause are causing additional problems. How to examine RTAs among developing countries was first discussed in 1992 during the formation of MERCOSUR, which includes Brazil, Argentina, Uruguay and Paraguay. Since the GATT was formally notified of MERCOSUR in March 1992, some contracting parties called on the GATT to form a working party under the Council to examine the agreement for purposes of consistency with Article XXIV of the GATT. However, a consensus was reached instead to have the Committee on Trade and Development (CTD) review MERCOSUR in light of both the Enabling Clause and Article XXIV and report back to the contracting parties and provide a copy of its report to the Council. With the establishment of the new CRTA in February 1996, examinations are now performed by this Committee. A similar debate regarding the AFTA has been raised, but there has been no consensus so far. Only the CTD has been notified of the agreement.

As noted above, the disciplines regarding free trade agreements in the Enabling Clause today remain unclear. Standards of Review and associated procedures need to be clarified to avoid the abuse of free trade agreements based on the Enabling Clause. Following the instruction of the Ministerial Declaration at the Doha Ministerial Conference in November 2001, discussions about issues such as the clarification of procedure to improve the transparency of RTAs are ongoing in the Negotiation Group on Rules. As described above, on 14 December 2006 the WTO General Council adopted a Transparency Mechanism for regional trade agreements (*see* 3(b) below for details). This Mechanism is applied to the RTAs under the Enabling Clause. The CTD implemented this Transparency Mechanism for RTAs falling under paragraph 2(c) of the Enabling Clause. The CTD shall convene in dedicated session for purposes of performing the functions established under this Mechanism.

3) Issues Studied by the Committee on Regional Trade Agreements (CRTA): Strengthening Disciplines and Procedures

With the growing number of RTAs, an increase in the burden to review regular notifications from existing RTAs was anticipated. In view of these developments, it was agreed to establish a single committee, which would be in charge of all RTA reviews, thereby improving the efficiency of the review process. The General Council established the "Committee on Regional Trade Agreements (CRTA)" in February 1996 as a special committee to review regional integration. The CRTA is solely responsible for all of the reviews that formerly were conducted by individual working parties for each RTA under the direction of the Council on Goods, Council on Services and the CTD. The CRTA also provides analysis of the impact of RTAs on the multilateral free trading system. More specifically, the CRTA has been assigned the following terms of reference: (a) to carry out the examination of notified RTAs[1]; (b) to consider how the required reporting on the operation of such agreements should be carried out and to make appropriate recommendations to the relevant bodies; (c) to develop procedures to facilitate and improve the examination process; and (d) to consider the systemic implications of such agreements and regional initiatives for the multilateral trading system and the relationship between them (so-called "systemic issues").

The November 2001 Doha Ministerial Declaration included all of the above items except (a) for negotiation in the New Round. The items are currently being discussed in the WTO Negotiating Group on Rules.

* The outline and review status of notified RTAs are disclosed on the WTO website.
(http://www.wto.org/english/tratop_e/region_e/region_e.htm)

(1) Examination of RTAs

According to the WTO's Report, 625 RTAs have been reported to the WTO as of February 1, 2016. (Of these, 431 are based on GATT Article XXIV, 41 are based on the Enabling Clause, and 153 are based on GATS Article V.) (Note: RTAs reported more than once under separate bases (GATT, the Enabling Clause and GATS) or reports made due to new member countries participating in existing agreements have only been counted once in these figures.) The examinations of facts are still proceeding, but none of the reports have been adopted since the CRTA was established. (Reference data: 18 reports were adopted prior to the establishment of the CRTA, and there are 8 RTAs without reports). Examination reports include a compilation of arguments from both sides. Furthermore, subsequent to the adoption of a Transparency Mechanism on 14th December 2006, Factual Presentations compiled by the Secretariat are also now considered. (Factual presentations suspended: 4; factual presentations in process of preparation: 98; factual presentations completed: 219). In addition to this, Factual Abstracts are prepared in regard to RTAs for which examinations of facts were completed before the adoption of the Transparency Mechanism. (Factual abstracts completed: 72)

(2) Review to Improve the Examination Process

To facilitate and improve the examination procedures by solving problems related to the increasing number of "after the fact" examinations and to insufficient provision of information for

[1] Overviews and reports on the status of inspections of regional trade agreements notified to the WTO are regularly updated on the WTO website:
(http://www.wto.org/english/tratop_e/region_e/region_e.htm)

the examination, the Negotiation Group on Rules is working to facilitate and standardize the provisions of information for examination of RTAs. On 14 December 2006 the WTO General Council adopted a Transparency Mechanism for regional trade agreements that clarify examination procedures. This is being provisionally applied as an "early harvest" stipulated by Paragraph 47 of the Doha Ministerial Declaration. The operation of the system was supposed to be reviewed in one year from the beginning of the operation to establish a permanent mechanism, but the examination results are not complete; as of February 2016, the review had not been undertaken. The following is an outline of the Transparency Mechanism.

1. Reporting of a RTA to the WTO Secretariat shall normally be done before the Agreement comes into effect.
2. The consideration by Members of a notified RTA shall be normally concluded in a period not exceeding one year after the date of notification.
3. The CRTA will implement the Transparency Mechanism for RTAs based on GATT Article XXIV and GATS Article V, while the CTD will implement it for RTAs based on the Enabling Clause, but the CTD shall meet in a dedicated session to consider the RTA, for the purpose of performing the functions established under this Mechanism.
4. The WTO Secretariat will prepare the requisite data for a factual presentation of the RTA. (Previously, most examination reports were prepared by the parties to the agreement.)
5. In general, one official session will be held to consider each RTA.
6. Documents and minutes of the session will be distributed to the relevant countries, and published on the WTO Secretariat website.

The clarified points are as follows:

1. Endeavour to inform the WTO about new negotiations reached at the conclusion of an RTA;
2. Convey to the WTO information on the RTA, including its official name, scope and date of signature, date of entry into force and any other relevant unrestricted information before the day of entry into force;
3. Clarification on submission of data by RTA Parties (preferential duties and MFN duties etc.); and,
4. Submit the data within ten weeks – or 20 weeks in the case of RTAs involving only developing countries – after the date of notification of the agreement.

(3) Review to Improve Reporting on the Operation of Agreements

Procedures to report on the operation of RTAs are determined under the Transparency Mechanism as follows.

1. The changes affecting the implementation of an RTA shall take place as soon as possible after the changes occur.
2. At the end of the RTA's implementation period, the parties shall submit to the WTO a short written report on the realization of the liberalization commitments in the RTA as originally notified.
3. Upon request, the relevant WTO body shall provide an adequate opportunity for an exchange of views on the communications submitted under 1 and 2 above.
4. The communications submitted under 1 and 2 above will be promptly made available on the

WTO website and a synopsis will be periodically circulated by the WTO Secretariat to Members.

(4) Review of "Systemic Issues" on RTAs

Discussion aiming to clarify the WTO's disciplines governing RTAs is ongoing in the Negotiation Group on Rules. The main points of the systemic issues include the "substantially all the trade" requirement and the concept of "other restrictive regulations of commerce" (Article XXIV: 8 of GATT) (*see* Figure II-16-10). Japan participates in the discussion aiming at a high level discipline so as not to undermine the multilateral trade system under the WTO by the RTAs.

Figure II-16-10 Major Points of the Systemic Issues Relating to WTO Rules for RTAs

1) "The general incidence of ORCs" clause in Article XXIV: 5

Article XXIV: 5 states that RTAs shall not raise duties and ORCs to the trade of third parties, but there is contention over how to judge whether barriers have risen. Members have agreed that the evaluation under Article XXIV: 5 of "the general incidence of the duties and ORCs" shall in respect of duties and charges be based upon an overall assessment of weighted average tariff rates and of customs duties collected, but there is still no agreement on the method to be used in overall assessment of "the general incidence of ORCs."

2) Relationship between Article XXIV: 4 and Articles XXIV: 5-9

Article XXIV: 4 states that the purpose of an RTA should be to facilitate trade among the parties and not to raise barriers to the trade of third parties. Articles XXIV: 5-9 define the requirements and criteria for "duties and ORCs" maintained in an RTA, the obligated procedure under the GATT. In addition, definitions of CUs and FTAs are provided.

The Members ha a divergence of opinions. One view, expressed by the EU and other Members, has been that Paragraph 4 is clarified and implemented by the provisions of Paragraphs 5-9, which follow it. In other words, Paragraph 4 itself is not a standard of judgment -- if the requirements of the provisions of Paragraphs 5-9 are met, Paragraph 4 is then automatically met. The EU, and others, therefore argue that even if the formation of a customs union results in the raising of new barriers to the trade of other contracting parties with respect to individual measures, a customs union will not be recognized to "raise barriers to trade of other contracting parties" in Paragraph 4, as long as the general incidence of ORCs "on the whole" is not higher or more restrictive than that in Paragraph 5(a). The other view has been that Paragraph 4 is itself a standard of judgment.

3) The "substantially all the trade between the constituent territories" clause in Article XXIV: 8

Article XXIV: 8 states that the range of liberalization under a customs union and an FTA must be "substantially all the trade between the constituent territories." No criteria have been agreed to for determining what constitutes "substantially" all trade in Articles XXIV: 8. Two distinct conceptual views exist: one emphasizes trade-based criteria, and the other calls for tariff line-based criteria. It has been proposed that the qualitative view of the term "substantially" all the trade which basically focuses on the possibility of exclusion of major sectors from intra-RTA trade liberalization should be considered.

4) Relationship between Article XXIV:8 and other provisions of the WTO Agreements

Article XXIV: 8 stipulates that the possible exceptions to "the duties and ORRCs" to be eliminated include those measures found in Articles XI, XII, XIII, XIV, XV and XX. The fact that Article XIX (Emergency Measures) and Article VI (Anti-dumping Measures) are not mentioned

among the possible exceptions is a source of contention. A number of questions have been raised in CRTA discussions within the context of either the extended scope of WTO obligations after the Uruguay Round or the formation of a new customs union, or both. Specifically, the issue is whether a customs union's existing measures such as safeguards measures, anti-dumping measures or import restrictions (against third countries) can or should automatically be extended to new members of the union, and whether RTA members can impose a safeguard or anti-dumping type action only against countries outside of the region. Different views have been expressed on whether they are justified by Article XXIV: 8 in the CRTA.

3. ECONOMIC ASPECTS AND SIGNIFICANCE

There are static and dynamic effects resulting from regional integration of trade and investment.

1) STATIC EFFECTS

The elimination of trade barriers between parties due to regional integration results in changes in the prices of goods and services traded in the region and corresponding changes in volumes. The economic welfare of both parties and non-parties to the RTA increase. When barriers within the region are reduced and imports and exports between parties expand, "trade creation" enables consumers in importing countries to consume the same imported goods and services more cheaply, while allowing producers in the exporting country to earn higher profits from exports, improving the economic welfare of both parties.

The elimination of trade barriers, however, only applies to the RTA member parties. Thus, some of the goods and services that had been imported from non-parties will instead be imported from the member parties in what is called "trade diversion." The process of imports from countries with low productivity replacing imports from countries with high productivity reduces the economic welfare of the countries within the region.

2) DYNAMIC EFFECTS

In addition to static effects, there are two other paths by which regional integration affects the economic growth of parties.

(1) Economic Growth from Productivity Gains

Regional integration improves productivity, and thereby increases the economic growth of participating parties. Productivity can be improved as follows: the elimination of trade and investment barriers within the region expands the size of markets, achieving economies of scale that improve productivity (market expansion); the inflow of cheaper goods and services and the entry of foreign capital encourage competition within domestic markets and increases productivity (competition promotion); the inflow of foreign managers and technicians spreads managerial expertise and technology, which improves productivity (technological spillover); and parties share expertise on more effective policies and regulations, which improves productivity (policy innovation).

(2) Economic Growth from Capital Accumulation

Regional integration reduces the uncertainty associated with the isolation policies and regulations of parties, and may increase the expected return from investments in parties. Increases

in return of capital results in the inflow and accumulation of foreign capital in the form of direct investments by parties and non-parties from abroad, which contribute to the expansion of production volumes within parties.

But if regional integration results in trade policies that discriminate against products from non-parties, then it may distort the investment pattern between regions (investment diversion). For example, if regional integration results in stricter rules of origin for non-parties' products, then it will encourage direct investment in the region rather than exports to it.

3) ECONOMIC EVALUATION OF REGIONAL INTEGRATION

The total impact of these effects on both parties and non-parties will depend upon the specific content of the agreement, the market sizes of parties, income levels, technology levels and industrial structures. From the perspective of static effects, the impact of regional integration on non-parties is by its nature to create relatively higher barriers even if absolute barriers are not increased. Imports from non-parties are placed at a competitive disadvantage to imports from parties.

However, if the dynamic effects produce growth in real income levels for parties, an increase in trade with non-parties can be expected. Meanwhile, improved productivity for regional industries reduces the opposition to liberalization of trade with non-parties, resulting in a positive effect on future worldwide trade liberalization.

The reduction of tariffs through multilateral efforts has generally decreased the level of discrimination against non-parties. Nevertheless, new rules and policies that discriminate against and disadvantage non-parties can still be seen. Below are concrete examples of measures found in some RTAs that may violate GATT/WTO principles and disciplines:

1. Conditional rules to not apply tariffs on certain products that are applicable only to certain corporations, but that are not applied to new entrants;
2. Increase of tariff rates imposed on non-parties with the adoption of a regional integration agreement.

These problems must not be repeated in the process of regional integration. Integration should be pursued in such a way that non-parties can enjoy positive trade effects while the substantial trade barriers are eased. In this respect, "open regional integration," the goal pursued by APEC, is an effective measure.

B. MAJOR CASES

The following cases have been brought before the WTO Dispute Settlement Body as examples of disputes involving regional integration. Their compliance with GATT Article XXIV, however, has not always been clarified.

(1) Quantitative Restrictions in the EU-Turkey Customs Union (DS34)

Turkey unilaterally imposed quantitative restrictions on textiles effective January 1, 1996, when joining the Customs Union Agreement with the EU. These restrictions enable the EU to preserve remaining restrictions on textile and clothing products under the Multi Fibre Arrangement (MFA) since they cover, exactly the same items for which the EU has quantitative restrictions. Japan believed that this was a violation of Article 2 of the Agreement on Textiles and Clothing, which

bans the imposition of any new import restrictions other than transitional safeguards for all measures except those in place prior to the launching of the WTO. It also clearly violates GATT Article XI, which provides for a general ban on quantitative restrictions, as well as Article XXIV: 5(a) stipulating that ORCs under a customs union shall not be higher or more restrictive than those prior to the formation of such union. In this case, Japan participated as a third party in both the WTO panel and the Appellate Body proceedings. The WTO found that these restrictions violated Articles XI and XIII of the GATT and Article 2 of the Agreement on Textiles and Clothing.

(2) The Fourth Lomé Convention and EU Restrictions on Banana Imports (DS27)

In December 1989, the EU signed the Fourth ACP-EEC Convention of Lomé with countries of Africa, the Caribbean, and the Pacific (ACP). The Convention provided for preferential treatment between Members and their former colonies and under it ACP countries received preferential treatment for banana imports. The number of ACP State parties to the Lomé Convention at present is 71, 54 of which are WTO Members.

Prior to market integration, the EU banana import regime waived the 20 percent *ad valorem* tariff on imports from ACP States under the Lomé Convention, allowing their bananas to be imported tariff-free. Individual EU States could, however, impose quantitative restrictions. In February 1993, a panel was established at the request of Colombia, Costa Rica, Guatemala, Nicaragua, and Venezuela (*EEC-Member States' Import Regime for Bananas* (1993)). The panel report, issued and circulated to Members in June 1993, found the quantitative restrictions of EU members to be in violation of Article XI: 1 of the GATT (general ban on quantitative restrictions), and the special measures favoring ACP bananas to be in violation of Article I of the GATT and unjustified under Article XXIV of the GATT. The EU did not, however, allow this panel report to be adopted.

In February 1993, the EU decided to replace quantitative restrictions on banana imports with a tariff quota regime, and to move to a specific duty rather than an *ad valorem* duty. The change took effect in July 1993.

Five countries (Colombia, Costa Rica, Guatemala, Nicaragua, and Venezuela) maintained that this import regime violated Articles I, II, III and XI of the GATT.

Consultations between parties failed to reach a mutually satisfactory solution, so a panel was established at the request of these countries in June 1993 (*EEC-Import Regime for Bananas* (1993)). The panel issued and circulated its report in February 1994, finding: (1) the change from *ad valorem* to specific duties to be in violation of Article II:1 of the GATT (requirement to apply tariffs that are not any more disadvantageous than the bound tariff); (2) discrimination in the assignment and tariff rates for tariff quotas to be in violation of Article I because ACP bananas were given preferential treatment over those of other countries; and (3) the FTA provisions of GATT Article XXIV did not provide justification for the violation of Article I.

In considering whether the preferential treatment of ACP bananas was justified in terms of GATT Article XXIV, the panel focused on the Lomé Convention and the fact that only the EU undertook the obligation to eliminate trade barriers; the ACP countries were under no obligation whatsoever. It, therefore, found that a non-reciprocal agreement, in which only some of the parties in the region eliminate ORCs, did not constitute an FTA as defined in Article XXIV. The interpretation that the EU had advocated under the provisions of Part IV of GATT (Trade and Development) - that the unilateral elimination of barriers to trade by developed countries for the benefit of developing countries in treaties in which developing countries undertook no obligation to liberalize should be considered to meet the requirements of Article XXIV - was not adopted in light of the fact that a

waiver of the general MFN treatment obligation had been granted, and that an agreement had been reached on the Enabling Clause.

The panel report was presented to the Council in March 1994, but the EU blocked its adoption. Shortly before the GATT terminated at the end of 1995, the EU and the ACP States applied for a waiver under Article I: 1 for the Fourth ACP-EEC Convention of Lomé. It was granted by the session of the Contracting Parties to the GATT 1947 in December 1994.

During the Uruguay Round negotiation, the EU offered an increase in the tariff quota on bananas in exchange for withdrawal of the panel proceedings and reached an agreement with all countries except Guatemala. In January 1995, the quota allocations were implemented with respect to Colombia and Costa Rica according to the agreement.

Later, after the waiver, a new EU banana import system was established, but it resulted in a complaint being filed in May 1996 by the United States, Guatemala, Honduras, Mexico and Ecuador, claiming violations of Articles I and XIII. A panel was established in May 1996. (Reports were issued by the Panel in May 1997; and by the Appellate Body in September of the same year. The reports were adopted by the DSB in October 1997. (*See* Chapter 1 Most-Favoured-Nation Treatment Principle for a discussion of the content of this report. *See* Chapter 15 "Unilateral Measures", Part II for the dispute between the United States and the EU regarding the implementation of the recommendations.)

(3) Measures Affecting the Import of Retread Tires by Brazil (DS332)

Brazil introduced measures to prevent the import of retreaded tires, as well as a system of fines in regard to these prohibitions. It exempted the MERCOSUR countries from applicability of the measures. In the light of this, the EU claimed violation of GATT Article I: 1, Article III: 4, Article XI: 1), and Article XIII: 1. In response, Brazil claimed that the measures were justified under GATT Articles XX(b) and (d) and Article XXIV.

Since bilateral consultations did not lead to an agreement, a Panel was formed in January 2006. The Panel issued its report in June 2007 in which it acknowledged the applicability of GATT Article XX(b) to Brazil's measures. At the same time, however, the Panel found that the significant quantity of retread tires imported based on interim injunctions issued by Brazil's domestic court was equivalent to a "disguised restriction on international trade", and that it breached GATT Article XI, being incompatible with the text of the article. The Appellate Body issued its report in December 2007. While it reversed the Panel's findings that the imports of used tires pursuant to the court injunctions resulted in the import ban being applied in a manner inconsistent with GATT Article XX, it supported the conclusion of the Panel in regard to the violation of GATT Article XI. These conclusions were adopted by the DSB in the same month.