Chapter 15

REGIONAL INTEGRATION

1. OVERVIEW OF RULES

The global economic regime 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, RTAs account for a considerable share of world trade (*see* Figures 15-1, 15-2). In the European Union, 66.8% of the gross value of exports from EU member states are to other EU member states; 64.6% of the gross value of their imports are from other EU member states. A similar situation exists with regard to NAFTA, with 55.8% of the gross value of exports going to other NAFTA member countries.

Figure 15-1
Share of Major RTAs in the Value of World Trade (Trade in Goods)

	Export				Import			
	Amount (2005)		Increase Ratio (%)		Amount (2005)		Increase Ratio (%)	
	(Billion $US)	Share (%)	2005	00-05	(Billion $US)	Share (%)	2005	00-05
World	10159	100.0	13	10	10511	100.0	13	10
North America	1478	14.5	12	4	2285	21.7	14	6
The US	904	8.9	10	3	1732	16.5	14	7
South and Central America	355	3.5	25	13	298	2.8	23	8
Europe	4372	43.0	8	11	4543	43.2	9	10
CIS	340	3.3	28	18	216	2.1	25	22
Africa	298	2.9	29	15	249	2.4	19	14
Middle East	538	5.3	35	15	322	3.1	17	14
Asia	2779	27.4	16	11	2599	24.7	16	12
Japan	595	5.9	5	4	515	4.9	13	6
China	762	7.5	28	25	660	6.3	18	24
EU	4001	39.4	7	10	4135	39.3	9	10
NAFTA	1477	14.5	12	4	2268	21.6	14	6
MERCOSUR	163	1.6	21	14	114	1.1	20	5
ASEAN	653	6.4	15	9	594	5.7	16	9

Source: WTO Annual Report 2006 International Trade Statistics (by the WTO Secretariat)

Note: Increase Ratio of 2005 is in comparison with year 2004.

Figure 15-2
Ratio of Intra and Extra Trade Among Major RTAs (Trade in Goods)

	Export (2005)					Import (2005)				
	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	4001	66.8	6	33.2	10	4135	64.6	6	35.4	14
NAFTA	1477	55.8	11	44.2	12	2268	34.5	11	65.5	15
MERCOSUR	163	12.9	23	87.1	20	114	19.7	25	80.3	17
ASEAN	653	24.9	15	75.1	15	594	24.3	20	75.7	15

Source: WTO Annual Report 2006 International Trade Statistics (by the WTO Secretariat)
Notes: *1-$US, in billions
*2-S: Share (Year 2005)
*3-IR: Increase Ratio 2005 (In comparison with year 2004)

The WTO 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 15-3 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. The difference between them is that under a CU, all external and internal tariff rates and trade rules for goods traded among the contracting parties must be uniform, but there is no need to make them uniform under an FTA.

This chapter discusses RTAs and regional cooperation arrangements like the Asia-Pacific Economic Cooperation (APEC) that seek similar objectives with different paling means, within the WTO context. We use the term “regional integration” to cover both.

Article XXIV of the GATT exempts RTAs from the most-favoured-nation 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 most-favoured-nation 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 most-favoured-nation principle as long as they conform to the conditions outlined in Figure 15-3, below.

Figure 15-3
Conditions of Customs Unions, FTAs and Interim Agreements Under Article XXIV of the GATT

Conditions Under Article 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 the above (a) or (b) -- (c) any interim agreement shall include a plan and schedule for the formation of such a customs union or of such a 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 FTAs 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)).

So far, each notified RTAs has been examined to determine whether it is consistent with Article XXIV of the GATT by working parties established separately for each notified 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) in 1957 and only six cases 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 conflicts 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 15-4, 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 15-5).

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 have begun and 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 will be provisionally applied as an "early harvest" stipulated by Paragraph 47 of the Doha Ministerial Declaration. The operation of the system will be reevaluated in one year, so as to establish a permanent mechanism. Future negotiations will include debate on the clarification of levels of liberalization that should be achieved by regional trade agreements.

The levels of liberalization achieved by Japan's Economic Partnership Agreements (EPA) are detailed in the following.

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 imports from Singapore to Japan, 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.

In April 2005 the Japan-Mexico EPA took effect. It will eliminate tariffs for approximately 98% of the value of Japanese exports to Mexico, approximately 87% of the value of Mexican imports to Japan, and approximately 96% of the total trade value between the parties within 10 years of taking effect.

In July 2006 the Japan-Malaysia EPA took effect. It will eliminate tariffs for approximately 99% of the value of Japanese exports to Malaysia, approximately 94% of the value of Malaysian imports to Japan, and approximately 97% of the total trade value between the parties within 10 years of taking effect.

In September 2006 the Japan-Philippines EPA was signed. It will eliminate tariffs for approximately 97% of the value of Japanese exports to the Philippines, approximately 92% of the value of Philippine imports to Japan, and approximately 94% of the total trade value between the parties within 10 years of taking effect. Preparations for the EPA to become effective are currently underway.

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.

The tariff elimination rates of individual FTA/EPA in other countries are provided below, based on reports of regional trade agreements produced by the Committee on Regional Trade Agreements (CRTA).

For US-ratified FTAs, tariffs were to be eliminated within 10 years of taking effect for 99% of the value of intra-area trade value in NAFTA (implemented in 1994) and 99% of the total trade value between the parties in the US-Jordan FTA (implemented in 2001). In the United States – Australia FTA (implemented in 2005), Australia agreed to eliminate tariffs for all items, while the US established some exempt categories for agricultural and fishery products, making the tariff elimination rate for all categories approximately 98%.

In the Canada-Chile FTA (implemented in 1997), the tariffs for 100% of the value of imports to Canada from Chile, 88.5% of the value of imports to Chile from Canada, and 93.4% of the total trade value between the parties will be eliminated within 10 years of the Agreement taking effect. Chile's rate of tariff elimination is low; however, the period for tariff elimination is longer than 10 years (up to 18 years). Chile's rate of tariff elimination becomes 99.5% when these longer elimination period items are taken into account.

In Chile's FTA with South Korea (implemented in 2004), the tariffs for 77.3% of the value of imports to Chile from South Korea and 99.3% of the value of imports to South Korea 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 becomes 96.2% if 13-year-elimination items are taken into account.

MERCOSUR (implemented in 1991) is a trade union based on the Enabling Clause and consists of Brazil, Argentina, Paraguay, and Uruguay. Although in principle MERCOSUR eliminates intra-regional tariffs, individual countries have exemptions for items such as sugar. A trade–value-based evaluation of the intraregional tariff elimination rate yields a figure of approximately 95%. (*See* http://www.mre.gov.br/ingles/politica_externa/mercosul/index.asp)

In Europe, the EC (implemented in 1958) committed to tariff elimination for all items. In addition, tariffs are to be eliminated within 10 years of implementation of the EC-Mexico Agreement (implemented in 2000) and the EC-Chile Agreement (implemented in 2003), both with a tariff elimination of 97.1% for trade value between the countries.

In Asia, AFTA (implemented in 1992) set the goal of tariff elimination to be achieved by 2010 for original ASEAN member countries (Brunei, Indonesia, Malaysia, the Philippines, Singapore, and Thailand) and by 2015 for the new member countries of CLMV (Cambodia, Laos, Myanmar, and Vietnam). The final tariff elimination rate is planned to be approximately 99% of tariff lines. A Common Effective Preferential Tariff (CEPT) of 0%-5% exists as a mechanism to facilitate the realization of AFTA. Although each country performs an annual review and expansion of items covered by the CEPT, as of 2002 the tariff line based proportion of items covered by CEPT for all member countries was approximately 83% (approximately 98% for original ASEAN member countries).

In the China-ASEAN Agreement (implemented in 2003) there are sensitive track items where the final tariff rate is to be reduced to 0%-5%. China and original ASEAN member countries have limits of less than 400 HS 6-digit items and less than 10% of the value of imports, while CLMV have a limit of 500 HS 6-digit items. Subtracting these amounts yields a final tariff reduction rate for both trade value and tariff line bases that is at the very least more than 90%.

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 tariffs. The Australia-Thailand FTA (implemented in 2005) commits to an elimination of tariffs within 10 years of agreement enactment, with coverage of 100% of the value of imports from Thailand to Australia and 99% of the value of imports from Australia to Thailand. Both Australia and New Zealand have achieved the 100% tariff elimination rate.

Figure 15-4

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 consequence 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 Anti-Dumping Agreement.

(c) Subsidies Agreement (Article 16.4)

- Same provisions as in the Anti-Dumping 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)

In preferential tariffs in RTA, 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 15-5
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 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 made to 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 favorable 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 the condition of "(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)

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 was reached during the Tokyo Round negotiations and serves as

the basis for special treatment accorded to developing countries in matters of trade. The Enabling Clause exempts RTAs entered into among developing countries for the mutual reduction or elimination of tariffs and non-tariff measures from the most-favoured-nation principle under Article I of GATT, provided the following conditions detailed in Figure 15-6, below, are met.

Figure 15-6
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-favoured-nation basis (paragraph 3(b)).

Notification to the contracting parties, 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)).

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.

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 under the terms of reference 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 WTO Committee on Regional Trade Agreements (CRTA) in February 1996, examinations are now performed by this Committee. A similar debate regarding the AFTA (ASEAN Free Trade Area) 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

[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)

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.

(a) Examination of RTAs

According to the WTO’s Report, 211 RTA have been reported to the WTO as of September 15, 2006. The examinations of facts are still proceeding, but none of the reports have been adopted since the CRTA was established. (Examination not requested: 33; Factual examination not started: 65; Under factual examination: 19; Factual examination concluded: 69; Consultations on draft report: 7; Report adopted: 20.) All of the examination reports are mere drafts; they contain nothing more than descriptions of the pros and cons.

(b)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 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 will be provisionally applied as an “early harvest” stipulated by Paragraph 47 of the Doha Ministerial Declaration. The operation of the system will be reevaluated in one year, so as to establish a permanent mechanism. The main differences from the past procedures are as follows.

1. The consideration by Members of a notified RTA shall be normally concluded in a period not exceeding one year after the date of notification.
2. The CTD implements this Transparency Mechanism for RTAs falling under paragraph 2(c) of the Enabling Clause as before, but the CTD shall meet for purposes of performing the functions established under this Mechanism.
3. The WTO Secretariat prepares a factual presentation of the RTA.(Previously, the parties prepared it.)

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.

(c) 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.

(d) 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). Japan participates in the discussion aiming at a high level discipline not to undermine the multilateral trade system under the WTO by the RTAs.

Figure 15-7
Major Points of the Systemic Issues Emerged from 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 divergence of opinions was addressed by the Members. 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.

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." In such a case, the economic welfare of the countries within the region is reduced.

Dynamic Effects

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

(a) Economic Growth from Productivity Gains

Integration is a factor in improving productivity (*see* below). Regional integration increases the economic growth of participating parties.

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). Parties share expertise on more effective policies and regulations, which improves productivity (policy innovation).

(b) 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, 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.

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.

4. MAJOR CASES

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 MFA since they cover, exactly the same items for which the EU has quantitative restrictions. Japan believed that this was a violation of Article II 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. With regard to 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 II of the Agreement on Textiles and Clothing.

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

In December 1989, the European Community 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 in 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 favouring ACP bananas to be in violation of Article I of the GATT (Most-favoured-nation Treatment) 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 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 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 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 came 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 (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 most-favoured-nation 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 (Non-discriminatory Application of Quantitative Restrictions). 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 14 “Unilateral Measures” for the dispute between the United States and the EU regarding the implementation of the recommendations.)