How to make EPAs WTO compatible?

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Reforming the rules on regional trade agreements

By Bonapas Onguglo and Taisuke Ito*

This report aims to contribute to the preparations by the African, Caribbean and Pacific (ACP) Group of States for the negotiations with the European Union (EU) of new WTO (World Trade Organization)-compatible trading arrangement(s), with flexibility and special and differential treatment for ACP States, as agreed between the two parties to the Partnership Agreement signed in Cotonou, Benin in June 2000. It focuses on the option of economic partnership agreements (EPAs) which provide for the parties to progressively remove barriers to trade between them. An agreed principle governing new ACP–EU trading arrangements is their full conformity with the relevant provisions of the WTO. However, the reciprocity as would be required under prevailing WTO rules on regional trade agreements is likely to pose greater adjustment costs on the part of ACP States that decide to become party to an EPA, either individually or as a group. It is thus recognised in the Partnership Agreement that the ACP States would be provided more flexibility under the EPAs in trade in goods, in particular in relation to the pace of market opening and the product coverage. Also, the ACP States and the EU agreed to 'closely cooperate and collaborate in the WTO with a view to defending the arrangements reached, in particular with regard to the degree of flexibility available'. This is necessary because such flexibility needs to be appropriately covered under WTO rules, yet the relevant WTO provisions governing regional trade agreements applicable to developed countries, namely Article XXIV of GATT 1994 and the Uruguay Understanding on that Article, do not contain explicit or adequate special and differential treatment for developing countries.

Thus, there exists an important legal lacuna in terms of the availability of special and differential treatment for developing countries in the WTO rules regarding North–South agreements, although it is precisely in such agreements that developing countries would most likely be in need of some flexibility. If future EPAs are to be legally valid and economically viable, it is imperative that special and differential treatment be made available to developing countries that enter into reciprocal trade agreements with developed country trading partners, and that such treatment be firmly incorporated into the relevant WTO rules. This report examines the case for, and draws up some suggestions on ways to, incorporating special and differential treatment into the WTO rules applicable to North–South regional trade agreements, in particular in Article XXIV of GATT1994, that would enable future EPAs to allow greater flexibility for ACP States to meet the test of WTO conformity. Such adjustments could be undertaken in the context of multilateral trade negotiations on WTO rules under the Doha work programme adopted by the Fourth WTO Ministerial Conference. An effort by ACP States and the EU in this respect requires the parties to elaborate their negotiating objectives on the new trading arrangements back-to-back with their participation in multilateral trade negotiations, so that the objectives of WTO-compatible arrangements with flexibility for ACP States can be promoted in a coherent and mutually supportive manner.

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Boxes

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ABBREVIATIONS

AAD	Agreement on the Implementation of Article VI of GATT 1994 (on anti-dumping,WTO)
ACP	African, Caribbean and Pacific Group of States
AGOA	African Growth and Opportunity Act
ASCM	Agreement on Subsidies and Countervailing Measures
ASEAN	Association of South–East Asian Nations
ASG	Agreement on Safeguards (WTO)
BOP	balance of payments
CBI	Caribbean Basin Initiative
CTG	Council for Trade in Goods (WTO)
CVD	countervailing duties
CARICOM	Caribbean Community and Common Market
COMESA	Common Market for Eastern and Southern Africa
CRTA	Committee on Regional Trade Agreements (WTO)
DCs	developing countries
DDA	Doha development agenda
DDCs	developed countries
DSB	Dispute Settlement Body (WTO)
DSU	Understanding on Rules and Procedures Governing the Settlement of Disputes (WTO)
EAC	East African Community
EBA	Everything but Arms initiative
EIA	Economic Integration Agreement on trade in services
EFTA	European Free Trade Association
EPA	economic partnership agreement
EC	European Commission
ECOWAS	Economic Community of West African States
EU	European Union
FTA	free trade area
FTAA	Free Trade Area of the Americas
GATS	General Agreement on Trade in Services (WTO)
GATT	General Agreement on Tariffs and Trade
GCC	Gulf Cooperation Council
GSP	Generalized System of Preferences among developing countries
GSTP	Global System of Trade Preferences
HS	Harmonized Commodity and Description and Coding System
LDC	least developed country
MERCOSUR	Southern Common Market
MFN	most-favoured-nation
MRA	mutual recognition agreement
NAFTA	North America Free Trade Area
NTB	non-tariff barrier to trade
ORC	other regulations of commerce
ORRC	other restrictive regulations of commerce
PICTA	Pacific Island Countries Trade Agreement
ROO	rules of origin
RTA	regional trade agreement
SAARC	South Asian Association for Regional Cooperation
SACU	South African Customs Union
SADC	Southern African Development Community
SAT	substantially all the trade
SDT	special and differential treatment
SPARTECA	South Pacific Regional Trade and Economic Cooperation Agreement
SPS	sanitary and phytosanitary measures
TBT	technical barrier to trade
UEMOA	West African Economic and Monetary Union
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organization

EXECUTIVE SUMMARY

The ACP–EU Partnership Agreement signed in Cotonou in June 2000 provides a new framework for economic and trade cooperation between ACP Group of States and the EU, whose specific modalities shall be introduced gradually during a preparatory period between March 2000 and December 2007, and which shall, *inter alia*, ensure full conformity with WTO provisions, including special and differential treatment for ACP States. The new trade and economic framework consists essentially of four pillars: (i) the temporary non-reciprocal preferential treatment for ACP States basically continuing the trade preferences under the Fourth Lomé Convention; (ii) economic partnerships agreements (EPAs) between willing ACP States and the EU; (iii) alternative arrangements to EPAs for ACP States that choose not to adopt EPAs; and (iv) special treatment for least-developed ACP countries in the form of duty-free and quota-free treatment for their exports.

The WTO compatibility of the resultant arrangements is a fundamental condition, albeit juxtaposed against the special and differential treatment (SDT) for ACP States. The pillar pertaining to the temporary continuation of the Lomé-type non-reciprocal trade preferences required a WTO waiver under WTO Agreement Article IX, which was granted in November 2001 by the Fourth WTO Ministerial Conference (two waivers on Article I and Article XIII of GATT 1994). The modalities for the least developed countries (LDCs) have been addressed by the EU's Everything but Arms (EBA) initiative as an extension of its Generalized System of Preferences (GSP) scheme. Such special GSP treatment for LDCs is compatible under the WTO with paragraphs 2(a) and (d) of the Enabling Clause. The modalities for possible alternatives to EPAs, and the attendant WTO compatibility, have yet to be identified as this pillar is scheduled for consideration in 2004 (although some preliminary analyses suggest a 'super-GSP' scheme). The modalities for the EPAs pillar would be defined through consultations and negotiations launched on 27 September 2002. In this respect, the WTO rules applying to regional trade agreements are subject to negotiations under the Doha work programme launched by the Doha WTO Ministerial Conference. Thus, the WTO compatibility aspect of future EPAs, especially as regards SDT for ACP States, needs to be addressed against this background. At the same time, the Doha work programme on WTO rules on RTAs as well as the emphasis placed in the work programme on SDT, provides a unique opportunity for the ACP Group of States to engage actively in the negotiations to introduce reforms that address their specific, common trade and developmental interests in forming EPAs with the EU and to secure their compatibility with WTO rules.

In North–South Regional Trade Agreements (RTAs) such as EPAs, developing countries are likely to need greater policy flexibility to adjust their economies to benefit from freer regional trade. The case is stronger for ACP States, most of which are small and vulnerable, if not LDCs. While future EPAs, being mixed North–South RTAs, would have to be notified under Article XXIV of GATT 1994, the major deficiency of this article is the absence of explicit SDT provisions for developing countries. This constitutes a legal lacuna and inconsistency in existing WTO disciplines, and holds true despite the existence of other GATT provisions that set out SDT for developing countries. While Part IV of GATT 1994 has provided a set of SDT provisions for developing countries since 1964, a WTO dispute settlement case established that Part IV of GATT 1994 is not applicable in conjunction with Article XXIV of GATT 1994. This undermines a possible claim that in a North–South RTA, the reciprocity requirement of Article XXIV of GATT 1994 can be waived for developing countries on the basis of the non-reciprocity exhortation of Part IV of GATT. The Enabling Clause has provided since 1979 a flexible framework of rules for developing countries in forming regional integration agreements among themselves ('South–South RTAs'). However, its current provisions do not cover those RTAs formed between developed and developing countries, as would be the case with future EPAs. Therefore, the result is that no SDT is applicable to developing countries forming North–South RTAs in conforming to requirements as provided under GATT Article XXIV.

The anomaly of the lack of SDT in GATT Article XXIV is most evident if a comparison is made with its counterpart article in the General Agreement on Trade in Services, namely GATS Article V. GATS Article V:3(a) clearly provides and locks in flexibility for developing countries in meeting conditions set out in GATS Article V:1 regarding the substantial sectoral coverage, absence or elimination of discriminatory measures in accordance with the level of development. Furthermore, GATS Article V:3(b) recognises a distinction between North–South RTAs and South–South RTAs by providing additional favourable treatment for developing countries in the case of the latter. This inconsistency in the availability of SDT between goods and services highlights the need for SDT in the context of North–South RTAs.

Although some flexibility is inherent in the current provisions of GATT Article XXIV resulting from the ambiguity in terminology and current permissive practice in the WTO in the application of this article, such *de facto* existing flexibility is inadequate in providing sound legal basis and security for the flexibilities that would be deemed necessary for ACP States under EPAs. First, such inherent *de facto* flexibility might still prove to be insufficient to provide sufficient legal cover for ACP flexibility under EPAs. Since such *de facto* flexibility does not differentiate between the flexibility available to developed and to developing countries, there persists a risk that the needs of developing countries for enlarging the scope of flexibility is curtailed by the systemic need for more stringent and effective disciplines (and thus less flexibility) for all WTO Members. Second such implicit flexibility is not appropriate in effectively providing legal security for, and to pre-empt future legal challenges against, EPAs. Thus, the existing flexibility can not be considered as substitute for SDT.

Therefore, the lack of SDT in GATT Article XXIV, together with the inadequacy of existing flexibility in that article to cater for the needs of developing countries under North–South RTAs, constitutes the case for reforming the relevant WTO rules to render SDT applicable to North–South RTAs in meeting the WTO conformity test. Since SDT is the modality to provide greater flexibility only to developing countries, it also responds to the systemic need for improved and clarified disciplines on RTAs. Three options are conceivable to that effect: (1) reforming Article XXIV of GATT 1994; (2) reforming Part IV of GATT 1994; and (3) reforming the Enabling Clause. Among them, there is the strongest case for the first option, i.e. reforming specifically Article XXIV of GATT 1994.

Reforming GATT Article XXIV translates into introducing elements of flexibility to those key benchmark requirements under GATT Article XXIV for developing countries through SDT, namely the 'substantially all the trade' (SAT) requirement, the transitional period, and the 'not-on-the-whole-higher-or-more-restrictive' requirements. In this respect, three approaches are conceivable: (i) generic provisions on SDT within Article XXIV of GATT in favour of developing countries; (ii) a review of specific provisions in Article XXIV of GATT; and (iii) a revision of GATT Article XXIV:10 on derogation from substantive requirements therein. Option (i) could consist in inserting a generic paragraph in Article XXIV of GATT 1994, or in the Understanding on the Interpretation of Article XXIV of GATT 1994, stating that the flexibility is to be provided for developing countries in terms of the key requirements stipulated in Article XXIV:5–8 (drawing some guidance from Article V:3(a) of GATS). The flexibility would in particular be applied to seek product and trade coverage and longer and more secure transitional periods. Option (ii) consists in revising and modifying specific provisions on the key requirements of Article XXIV of GATT, particularly Articles XXIV:5(c) and XXIV:8 (a)(i) and (b), so as to allow differentiation for developing countries. The aim of these changes is to allow flexible interpretation of the key requirements of Article XXIV of GATT 1994 for developing countries in the form of SDT, on the basis of which operationally 'greater flexibility' is defined specifically for developing countries. Option (iii) is a supplement to the two options and consists in rendering it easier for developing countries to seek derogation from the substantive requirements of GATT Articles 5–8.

The second option is to amend Part IV of GATT 1994 to render it applicable to North–South RTAs in conjunction with GATT Article XXIV. The reform would be geared towards rendering the non-reciprocity principle in multilateral trade negotiations, as provided in GATT Article XXXVI:8,

applicable to negotiations in the regional context. A key difficulty with this option lies in the fundamental irrelevance, as found in a GATT dispute panel ruling, of the non-reciprocity principle in multilateral trade negotiations to the conditions set out in GATT Article XXIV. First, SDT in GATT Article XXXVI:8, by definition, applies only to multilateral trade negotiations, and is thus irrelevant to regional trade negotiations. Second, GATT Article XXIV concerns conditions that individual RTAs have to meet, and not regional trade negotiations.

The third option is to extend the scope of the Enabling Clause beyond South–South RTAs to encompass North–South RTAs like EPAs. This would ensure that the maximum flexibility enjoyed by developing countries under this clause in the formation of South–South RTAs would also apply to North–South RTAs. It would, in effect, exclude future EPAs from the purview of GATT Article XXIV and its more stringent terms (compared with the Enabling Clause). A serious shortfall with this option, however, is that the legal validity of the Enabling Clause and its coverage of agreements formed among developing countries is increasingly being challenged by some WTO Members. Another is that the Enabling Clause, without any formal link to GATT Article XXIV conditions, could not guarantee reciprocity in the exchange of concessions between parties to an RTA, and thus may cover a non-generalised non-reciprocal preferential scheme such as an RTA, thereby circumventing the waiver requirements for such preferential schemes. This has systemic risk to the validity of unilateral preferences such as the GSP as well, since the Enabling Clause condition that unilateral preference is only allowed under the GSP scheme could also be circumvented.

Given the superiority of direct reform of GATT Article XXIV, there would be a further need, depending on negotiations, for operationalising the concept of 'flexibility' to be made available to developing countries in respect of the substantive and procedural requirements of GATT Article XXIV. Since the degree of flexibility to be made available specifically to developing countries through SDT would depend critically on the definition of generally applicable existing flexibility as well as concrete terms of 'flexibility' for developing countries, both elements may require operational definition and interpretation. The most relevant requirements for developing countries include the 'substantially all the trade' requirement for internal trade liberalisation and the transitional period. As to the former, possible modalities include the application of different methodologies for developed and developing countries (including the level of aggregation, subject of measurement, sectoral composition and treatment of non-zero preferential duties) and statistical threshold levels in measuring the SAT requirement for elimination of duties. This would allow for a lesser degree of market opening for developing countries. 'Other restrictive regulations of commerce' would need to be interpreted so that preferential application of trade remedy measures and other non-tariff measures by developing countries on intra-RTA trade would not be unduly impeded. The issue of the transitional period pertains both to its legal standing and its duration, including asymmetry. As RTAs are deemed to be 'interim arrangements' during the transitional period, securing legal protection from the requirements of GATT Article XXIV would leave significant flexibility for developing countries during that period. A transitional period of longer than 10 years could be secured by loosening the conditions for developing countries to meet the 'exceptional cases' test, and possibly by defining a maximum duration of transitional periods longer than 10 years.

This report points to some priority negotiating issues for ACP States under the Doha work programme on WTO rules on RTAs. First, the starting point for negotiations would be to retain the legal validity of the Enabling Clause for those RTAs formed among developing countries, including ACP States. The coverage of South–South RTAs under the Enabling Clause is to be considered *acqui* and not be subject to negotiation. Second, securing agreement among WTO Members on the incorporation of principle of SDT into GATT Article XXIV, possibly in the form of a generic paragraph, may well constitute a negotiating issue independent of other systemic issues. This would ensure special treatment for developing countries in meeting the requirements of GATT Article XXIV relative to generally applicable disciplines. For this purpose, a paragraph similar to GATS Article V:3(a) may prove to be useful. Third, the systemic issue debate on key substantive and procedural requirements on which the actual negotiations would be centred, would need to be geared towards ensuring the most favourable interpretation and operational understanding on the generally applicable flexibility in

respect of each key requirement, so that a sufficient degree of flexibility could be made available to developing countries. Such an exercise may be necessary, as the generally applicable flexibility would form the basis on which to build, as SDT, additional degrees of flexibility for developing countries. This is a way to maximise the degree of flexibility available to ACP States and developing countries in the application of GATT Article XXIV disciplines.

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