Ensuring that Regional Trade Agreements Complement the WTO System: US Unilateralism a Supplement to WTO Initiatives?

Matthew Schaefer

University of Nebraska College of Law, mschaefer1@unl.edu

Follow this and additional works at: http://digitalcommons.unl.edu/lawfacpub

Part of the Legal Studies Commons
Ensuring that Regional Trade Agreements Complement the WTO System: US Unilateralism a Supplement to WTO Initiatives?

Matthew Schaefer
Professor of Law, University of Nebraska College of Law.
Email: mschaefer1@unlnotes.unl.edu

ABSTRACT

In the mid-1990s, the policy debate within the WTO focused on whether regional trade agreements (RTAs) were building blocks or stumbling blocks for the WTO system, essentially questioning whether regionalism was appropriate at all from an economic policy perspective. Given the proliferation of RTAs since that time and the inability to roll back the clock, that policy debate has been replaced by a search for strengthened constraints on RTA activity that might ensure it complements the WTO system. Three major controversies within many existing RTAs are the exclusion of agriculture from coverage, complex and restrictive rules of origin, and varied treatment of the application of trade remedies. Despite some competing policy considerations, it is likely, on balance, that the WTO system would benefit if agriculture was required to be included in RTA coverage, if RTA rules of origin were simplified and liberalized, and if the controversy surrounding RTA treatment of trade remedies was cleared up. However, the search for constraints within the WTO system to achieve these results, either through the Doha negotiations or the dispute settlement system seems unlikely to succeed in the near future. Accordingly, enhanced and extended efforts by the US, either unilaterally or in conjunction with its RTA partners utilizing its negotiating leverage, may be a necessary supplement to efforts within the WTO in ensuring a more harmonious relationship between RTAs and the WTO system.

INTRODUCTION

Virtually every important WTO member is now party to a Regional Trade Agreement (RTA) and roughly one-half of world trade occurs under pref-
erential tariff rates. Through the end of 2006, over 368 RTAs were notified to the WTO of which over 260 occurred after January 1995, reflecting a surge in RTA activity that actually began in the late 1980s/early 1990s. It is estimated that by 2010, over 400 RTAs will have been implemented worldwide.\(^2\) The debate in academic and policy circles in the 1990s focused on whether RTAs were building blocks\(^3\) or stumbling blocks\(^4\) for the multilateral system. Specific criticism was directed at the United States for its pursuit of regionalism because of its undue bargaining power in bilateral and small group negotiations. However, US abstinence from RTA negotiations from 1995-2000 did nothing to stem the tide of regionalism. Moreover, the US has traditionally only turned to a robust regional agenda when the WTO system has stalled in achieving further trade liberalization.

Given the proliferation of RTAs, the inability to turn back the clock and the political and diplomatic capital the US has invested in reinvigorating its RTA agenda, the policy debate has moved to an acceptance of the existence of RTAs and a focus on mechanisms both within the WTO system and outside that system that might ensure that this robust RTA activity complements, rather than detracts from, the WTO system. Part I of this article examines three major controversies associated with RTAs: the exclusion of agriculture from significant liberalization in many RTAs, complex and restrictive rules of origin established by RTAs, and the varied treatment of trade remedy laws within RTAs. Part II examines existing WTO constraints on the use of RTAs and explores the possibility of strengthening WTO constraints, in particular to eliminate some of the negative consequences flowing from these controver-

---

2. See www.wto.org (click on trade topics and click on regional trade agreement).
3. Arguments include: (i) the domino effect--creating incentives for third countries, i.e. those outside a given RTA, particularly one featuring a large market such as the US or EU, to participate in multilateral liberalization to reduce negative preference margins they face; (ii) serving as laboratories for experimentation with rules in new areas, e.g. services, intellectual property, etc and (iii) locking in reforms in developing countries. For a discussion of many of these arguments, see, generally, Robert Z. Lawrence, ‘Emerging Regional Arrangements: Building Blocks or Stumbling Blocks?’ in Richard O’Brien (ed.), Finance and the International Economy (1991); Richard E. Baldwin, ‘A Domino Theory of Regionalism’, in Baldwin et al. (eds), Expanding Membership of the EU 25 (1995).
4. Arguments include: (i) those countries in RTA relationships with big markets have less incentive to engage in multilateral liberalization efforts within the WTO and thereby lessen their margins of preference; (ii) an alternative response for third countries is to pursue an RTA with the large market, i.e. become an ‘insider’ rather than ‘outsider’; (iii) RTAs use up necessary political capital and attention, as well as negotiating capacity, to the detriment of multilateral trade liberalization within the GATT/WTO system; and (iv) RTAs create a spaghetti bowl of trade regimes adding large administrative cost to traders and governments alike. See, generally, Jagdish Bhagwati and Arvind Panagariya, ‘Preferential Trading Areas and Multilateralism–Strangers, Friends or Foes?’ in Bhagwati and Panagariya (eds), The Economics of Preferential Trade Agreements (1996); Jagdish Bhagwati and Anne O. Krueger, The Dangerous Drift to Preferential Trade Agreements (1995).
sies. Part III considers what efforts the US could undertake either unilaterally or in conjunction with RTA partners to help ensure that regionalism complements the global trading system. The analysis in Parts II and III reveals a potentially large irony: unilateral actions by the US and actions in conjunction with its RTA partners using the significant negotiating leverage of the US in bilateral and regional negotiations may be more successful than efforts within the WTO, or at least a necessary supplement to efforts within the WTO, at ensuring that RTAs better complement the WTO system.

I. MAJOR CONTROVERSIES REGARDING RTAs

The original GATT (1947-94) and subsequently the WTO system (1995 to present) both allow an exception for RTAs in part because it was thought that the trade creation effects of an RTA that complied with certain conditions laid out in the GATT/WTO system would outweigh any trade diversionary effects (i.e. the growth in trade between the RTA countries would outweigh the loss of trade between third countries and the RTA countries). However, the ambiguities in the conditions laid out in the GATT/WTO system for RTAs have lead to at least three major controversies in the way RTAs have been structured: (i) many RTAs exclude agriculture from coverage, at least to some extent; (ii) many RTAs have highly complex and restrictive rules of origin that might divert trade from third countries as RTA partner countries use inputs from partner countries rather than cheaper inputs from third countries to comply with the rules of origin necessary to gain the preferential tariff rates under the RTA and (iii) many RTAs do not eliminate the application of trade remedies to products from RTA partner countries, thus not leading to full liberalization of internal trade within the RTA, but may give some special treatment in this regard, potentially creating third country impacts. Aside from the legal ambiguities allowing for these controversies, each of these major problems has many economic nuances and numerous competing policy considerations as not only must the trade creation v trade diversion issue be considered but also the impact of these RTA features on countries incentives to be forthcoming in WTO negotiations.

A. The exclusion of agriculture

A WTO study early in the Doha Round of negotiations confirmed, both in terms of percentage of trade and duty-free tariff lines, that agriculture is not liberalized nearly as much as industrial products in RTAs. Many RTAs utilize a negative list approach (covered unless specifically excluded) for industrial products and, in contrast, employ a positive list approach (not covered unless specifically included) for agricultural products. Additionally, when an agricultural product is included in an RTA, it tends to be subject to tariff reduction but not duty elimination. Finally, there is less harmonization across overlapping RTAs in agriculture and tariff peaks are more likely to remain in the agricultural sector.

The reason for this phenomenon is that the behavior of countries within their RTAs on agricultural issues tends largely to parallel their behavior on agricultural issues in the WTO. Under this line of thinking, the exclusion of agriculture is merely another symptom or manifestation of the same political sensitivities that prevent significant liberalization in the WTO. However, it may be that allowing RTA activity that largely excludes agriculture is indeed harming multilateral liberalization efforts within the WTO. RTAs that exclude agricultural products allow countries to obtain increased market access in industrial products and engage in new rule development without having to engage in the politically tough liberalization of agriculture—something that they could not get away with in the WTO’s ‘package deal’ framework of negotiations. Assuming the countries pursuing RTAs without agricultural liberalization would choose not to pursue them if they were required to include agricultural goods in a more fulsome manner, then the WTO would be the exclusive forum for them to pursue industrial goods liberalization and new rules creation, and they would only obtain this liberalization and the new rules in ex-

7. According to the WTO study, more than three-quarters of the RTA relationships had less than 50% of agricultural tariff lines at zero duty rates. See WTO Doc. WT/REG/W/46, 5 April 2002.
8. Particularly low levels of harmonization occur with EC, Israel and Turkey RTAs. See ibid.
9. Of course, for the small percentage of RTAs that constitute customs unions and achieve deeper levels of integration, such as the EU, the behavior in the WTO may be even more protectionist because of the potential for their negotiating position to gravitate towards the most protectionist country in the customs union. Experience seems to back this view up, although some commentators have argued the opposite—that creation of customs unions with deeper integration, as with the EU, actually leads to greater liberalization because the views/votes of the most protectionist member are offset by other members of the customs union and ‘national champions in every industry’ are no longer ensured. See Lawrence, above n 3. Which view is correct can depend on a variety of factors within the customs union, including voting practices, informal decision making practices, and other political and economic issues under consideration by member countries of the customs union at the time.
change for agricultural liberalization.\(^{10}\) Alternatively, countries might actually pursue RTAs that include agriculture more fully and thus start chipping away at the enormous protectionist sentiment in this sector, albeit with some potential for significant trade diversion as high MFN tariff rates charged to third countries impact demand from those countries as compared with RTA partner country products subject to preferential rates. Another possible scenario is that countries with defensive interests in the agricultural sector might simply pursue RTAs with countries that do not threaten their agricultural sectors, but this would at least reduce the amount of RTA activity and still increase the pressure on governments to utilize the WTO forum. Regardless of which of these scenarios played out, a requirement to include agriculture in RTAs would be a net benefit for the WTO system.

B. Complex and restrictive RTA rules of origin

RTAs include rules of origin to ensure that products more closely connected with a third country do not receive preferential treatment under the RTA without the third country paying reciprocal tariff concessions. RTA rules of origin tend to be more restrictive (stringent) than non-preferential rules of origin utilized by countries, particularly on sensitive items. Concerns have been expressed that overly restrictive RTA rules of origin magnify the trade and investment diversionary effect of RTAs. The more complex and restrictive the RTA rules of origin, the more they can lead to companies within the region using partner country inputs rather than cheaper third country inputs in order to ensure compliance with the rules of origin necessary to obtain the preferential tariff treatment afforded by the RTA.

The sheer complexity of the rules, particularly when one considers that many countries are parties to numerous overlapping RTAs, creates substantial administrative and compliance costs for traders and customs administrators (often referred to as the spaghetti bowl effect).\(^{11}\) Indeed, for products in which the MFN tariff rate is low (and thus there is a low preference margin) some traders simply elect to pay the MFN rate than suffer the administrative costs of complying with the RTA rules of origin (e.g. a significant amount of US-Mexico trade occurs at the MFN rate).

---

10. While some might counter that forcing agricultural liberalization in RTAs would simply use up countries’ political capital and reduce the chances for liberalization multilaterally, on balance, it appears that requiring RTAs to include agriculture would be a boost for multilateral liberalization, both in agricultural and other areas.

However, one irony is that further RTA activity may lessen this spaghetti bowl effect as ‘consolidation’ occurs among overlapping RTAs. Broad regional RTAs, such as the expansion of the EU from 15 to 25 countries after the enlargement of the EU to include most of central and eastern Europe in 2004, and the now-stalled Free Trade Agreement of the Americas (FTAA) negotiations among 34 countries, may reduce, although clearly not eliminate, the complexity. Another competing consideration is that stringent rules of origin maximize the incentives of third countries to engage in multilateral liberalization since they have little opportunity to ‘free ride’ on preferences in the RTA. Despite these competing considerations, on balance, it is generally agreed from a policy perspective that less stringent and less complex RTA rules of origin would be better at achieving GATT Article XXIV’s goal of creating trade among RTA partners without diverting it from third countries.

C. The treatment of trade remedies (safeguards, anti-dumping)

RTAs vary widely in how they address the application of trade remedy laws among members—from virtual exclusion from such remedies (although usually in the case of safeguards with the establishment of a lesser RTA-specific emergency remedy) to continued application of both global safeguards and anti-dumping laws. However, exclusion from trade remedy laws is rare compared to continued application of such laws.

Many countries are of two minds on the issue of trade remedies in RTAs. Most greatly desire to be excluded from the application of such laws, particularly by large market countries such as the US, in their RTAs with those countries as it would lead to greater trade liberalization. However, when they are outside an RTA offering exclusion, partial or full, from a trade remedy law, they believe their interests are hurt by such exclusion, i.e. they ‘take a bigger hit’ when remedies are applied. The WTO Appellate Body has not ruled on whether excluding RTA partners from the application of trade remedy laws is required, allowed or prohibited by GATT’s exception for regional trade agreements, but they have lessened the latter concern by ruling that there must be parallelism between the imports investigated and the remedy (i.e. a country cannot include RTA partner imports in the investigation—thereby making it more likely that imports will be viewed as a cause of injury to domestic industry—and then exclude them at the remedy stage).12

The treatment of trade remedy laws within US and other large market RTAs can have a significant impact on countries’ willingness to pursue mul-

---

tilateral liberalization. The US continues to be the largest user of anti-dumping laws (although the EU is also a large user and many developing countries are significantly increasing their use of such laws). If the US were to begin offering exclusion from anti-dumping laws in its RTAs, then those RTA partner countries would have a reduced incentive to engage in the multilateral liberalization processes. Similarly, safeguard remedial actions have substantially increased since the creation of the WTO in 1995 (and the banning of so-called gray measures such as voluntary restraint agreements). Thus, exclusion from application of global safeguards is also something desirable for US RTA negotiating partner countries.\footnote{The US market, in terms of MFN tariff rates, is relatively open. Thus, the largest complaint of foreign trading partners of the US tends to focus on extensive use of so-called ‘contingent protectionism’ or trade remedy laws.}

Of course, one could make similar arguments regarding exclusion of trade remedies to those made with respect to the inclusion of agriculture. If countries were required to exempt RTA partners from trade remedies, then at least some countries, such as the US, might largely cease RTA activity due to the political sensitivity of changing or weakening trade remedy laws. Alternatively, they may conclude RTAs that exempt partner countries from trade remedies, thus slowly chipping away at the protectionist sensitivities, although possibly increasing third country impacts. On balance, however, it is likely that multilateral liberalization efforts will benefit from the US preserving at least the anti-dumping negotiating chip for the Doha Round as this chip is one of the few significant ones the US maintains to force further MFN tariff liberalization within other countries (US MFN rates, as mentioned before, generally being quite low already).\footnote{Because application of US safeguards remedies is not as big a negotiating chip as anti-dumping laws, it is probably not too harmful to the WTO trade liberalization process if the US replaces global safeguards remedies with RTA-specific emergency remedies vis-à-vis its RTA partner countries.}

II. STRENGTHENED WTO CONSTRAINTS ON RTAs

The three major controversies surrounding RTAs persist due to the lack of clarity surrounding the existing constraints within the WTO. Institutional mechanisms within the WTO system do exist for clarifying and strengthening
these existing constraints, however, numerous complications have previously prevented and may continue to prevent the mechanisms from being successfully utilized.

A. Existing constraints

GATT Article XXIV permits the formation of customs unions, free trade agreements and interim agreements leading to the formation of such agreements ‘within a reasonable length of time’. However, the language of Article XXIV is broad, imprecise language that, when combined with inadequate review and monitoring, leaves considerable room in practice for auto-interpretation by members to an RTA. (The corresponding language in General Agreement on Trade in Services (GATS) Article V and the language in the Enabling Clause permitting RTAs between developing countries are filled with as much if not more uncertainty and wiggle room). Article XXIV declares that the purpose of an RTA should be to facilitate trade between its members and ‘not to raise barriers to the trade’ of third countries. In terms of internal requirements for an RTA, Article XXIV requires that ‘duties and other restrictive regulations of commerce (except, where necessary, those permitted by Art. XI, XII, XIV, XV, and XX)’ are eliminated with respect to substantially all trade’. In terms of external requirements, an RTA cannot impose ‘duties and other regulations of commerce that are higher or more restrictive’ than the general incidence of duties and regulations of commerce existing in the RTA members’ territories prior to the formation of the RTA. The Uruguay Round Understanding on Article XXIV clarified certain issues related to compensation negotiations and assessing tariff barriers affecting third party trade upon the formation or enlargement of a customs union and also clarified


16. These exceptions relate to certain agricultural programs (the scope of which has been reduced by the Uruguay Round Agriculture Agreement), balance of payments considerations, and the so-called general exceptions clause of GATT (protection of human health, conservation of exhaustible natural resources, etc.). The question is raised whether this list of exceptions is exclusive or not. One strong argument that the list is not exclusive is that it fails to list the so-called national security exception found in Art. XXI. It seems unlikely the drafters envisioned preventing a country joining an RTA from applying a security-related measure to its RTA partners. See Hudec and Southwick, above n 15, at 66.

17. While quite similar, the language regarding customs unions is not identical to that regarding FTAs, for the simple reason that customs unions adopt common regimes vis a vis third party trade while FTAs do not. See, e.g. the language ‘on the whole’ inserted with respect to customs unions but not FTAs.

18. The US basically succeeded in having its position on the three issues in contention at the time Spain and Portugal joined the EU in 1986 incorporated into the Uruguay Round Un-
that a reasonable period of time for an interim arrangement was generally to be taken to mean ten years. However, the Understanding did not clarify several terms related to the specific problems arising out of the increased RTA activity described above.

First, the term ‘substantially all trade’ was not clarified, leaving open the question of whether such a determination should be based on trade coverage or tariff lines or some combination. For example, the question can be raised whether an RTA that excludes agriculture meets the substantially all requirement if agriculture is a small percentage of trade between the RTA members (perhaps because of high trade barriers) and taking account of the fact that agricultural products constitute roughly 15% of tariff lines. The preamble to the Uruguay Round Understanding states that WTO members recognize that the contribution of RTAs to the expansion of world trade is ‘diminished if any major sector is excluded’. While this language might help influence the interpretation of the term ‘substantially all’, it is not an obligation in and of itself.

Second, the Understanding did not clarify whether the exceptions list to the substantially all requirement is an exclusive list or not. Thus, the question can be raised whether, internally, an RTA would be required (or at least permitted) to eliminate the application of trade remedy laws (e.g. safeguards authorized by GATT Article XIX and anti-dumping duties authorized by GATT Article VI) among members.

Third, the terms ‘other regulations of commerce’ and ‘other restrictive regulations of commerce’ were not clarified, leaving open the question of whether RTA rules of origin are included within the meaning of these terms. For example, the question can be raised whether rules of origin should be included in an assessment of whether barriers to third country trade are higher or more restrictive than pre-RTA barriers or even taken into account when

---

19. However, as Hudec and Southwick point out, there are some ‘conceptual problems’ in considering whether RTA rules of origin to fit within the term ‘other regulations of commerce’. Specifically, in considering whether such rules are ‘higher or more restrictive’ after the FTA than before, we run into the problem of what is the ‘before’—because prior to the RTA there were no RTA rules of origin. While one might look to rules of origin of other preferential programs or another RTA, the rules in those programs are designed to determine eligibility to a program with a fundamentally ‘different purpose or scope than the RTA’ under consideration. See Hudec and Southwick, above n 15, at 57. Note that there may also be complications in comparing different rule of origin regimes existing under different programs and agreements to determine whether one is more restrictive than the other. See ibid, at 59.
determining whether substantially all trade has been liberalized among RTA members.\textsuperscript{20}

B. Existing review and monitoring procedures\textsuperscript{21}

GATT Article XXIV requires countries to ‘promptly notify’ other WTO members when deciding to enter an RTA and to make available such information as will enable WTO members to make reports and recommendations. In practice, many notifications occur after RTAs are finalized. Under the GATT, individual working parties were established to examine RTAs that were notified to the body. In virtually every review, the working parties were unable to come to any consensus on the consistency of the RTA with Article XXIV requirements. In February 1996, the General Council created the Committee on RTAs in an effort to improve the review and monitoring of RTAs. However, significant problems remain. The committee has only reached consensus on WTO consistency in one case and even most factual examinations of RTAs prepared by the Committee have been held up from adoption. Further, the chairmen of the committee complained in 2002 of the unwillingness of countries to provide, or significant delays in providing, information on their RTAs for the factual examination reports. Some of this unwillingness was alleged to be a result of so-called ‘dispute settlement awareness’ (i.e. fear that the information will lead to and/or be used against them in a future dispute settlement case).

C. Forums for strengthening constraints

Two possible avenues exist for strengthening the current WTO constraints on RTAs: the broad Doha Round negotiations (originally launched in 2001) and the WTO dispute settlement system.\textsuperscript{22}

1. Negotiations

The Doha Ministerial Declaration launching the current round of WTO negotiations provides for the following mandate for negotiations on RTAs: ‘clarifying and improving disciplines and procedures under the existing WTO provisions applying to regional trade agreements’.\textsuperscript{23} The literature on

\textsuperscript{20} For instance, if a high percentage of trade continues to occur under MFN rather than RTA rates because of complex rules of origin, one might argue that this portion of trade has not been liberalized within the RTA.

\textsuperscript{21} Information in this section comes from the WTO web site, www.wto.org (click on regional trade agreements).

\textsuperscript{22} I leave aside the slight possibility of the WTO membership utilizing its formal interpretation or amendment powers because such powers have rarely been utilized and would almost surely not occur in the context of RTA disciplines with negotiations in the Doha Round occurring that allow for trade-offs among many issues.

\textsuperscript{23} See Doha Ministerial Declaration, para. 29, adopted 14 November 2001.
RTAs is filled with many far-reaching proposals for improving WTO disciplines. Most of these are not politically feasible, although some far-reaching proposals in the literature have actually seen reflection in government proposals.

For example, in an effort to end the discrimination against third countries created by RTAs, it has been suggested that the WTO should require that an ‘open accession’ clause be included in all RTAs. The proposal ignores the key question of what concessions would be required of countries wishing to join, keeping in mind that the phase out periods on tariffs on certain goods is important even if all trade were to be liberalized within an RTA. Such a requirement also ignores the non-trade goals that are important considerations when choosing RTA partners (e.g. Cuba is not a participant in FTAA negotiations). Yet, Taiwan proposed that the WTO require such a clause to be put in all RTA agreements, explaining in response to criticism, that it simply would require an opportunity to negotiate. There have also been suggestions that the WTO should hold negotiations to harmonize preferential rules of origin. However, the exceedingly slow progress in the harmonization negotiations of non-preferential rules of origin (initially due to be concluded in 1997 but continuing today) cautions against proceeding with negotiations on the trickier topic of preferential rules of origin.

Another proposal in the literature was a proposal that all RTA tariff cuts be extended on an MFN basis five years from the cut thereby limiting the length of time preferences under an RTA could remain in place to five years. This proposal, if adopted wholesale, might lead to ‘dirty’ RTAs with even more numerous carve-outs and/or dramatically reduce the incentive of third countries to engage in multilateral liberalization (and simply free-ride on RTA tariff cuts as they are multilateralized). However, a US proposal in the Doha Round in 2003 for elimination of all tariffs globally by the year 2015 would have achieved the advantages of the academic proposal (by limiting the length of time that RTA preferences would remain in place) but without the disadvantages because it would not allow for any free riders. Of course, most other countries considered the US proposal too far-reaching and politically infeasible as well because developing countries would lose their preferences under GSP and other schemes in the industrialized countries’ mar-

25. It should be noted that the US Administration previously explored with Congress the idea of ‘docking’ agreements in which the US would negotiate a deal with one nation in a region and another country in the region ‘could join into the basic set of rules and structure—probably with a separate market access agreement’, according to former USTR Ambassador Zoellick.
27. See Joseph A. LaNasa III, 90 American Journal of International Law (1996) at 625, 637, fn 60 (not proposing it, but describing that it was at one point considered).
kets and there would be adverse consequences for those developing countries heavily dependent on duties as a source of government revenue (in the absence of improved tax structures and enforcement). To date, only very modest transparency proposals have succeeded in the Doha negotiations and even modest substantive or systemic proposals continue to create significant disagreement among WTO members.

a. Transparency agreement. The Doha negotiations led to an agreement among governments to increase transparency regarding RTAs.\(^\text{29}\) In July 2006, WTO members agreed to provisionally implement, pending conclusion of the negotiating round, an agreement that requires WTO members to: (i) inform other members of the launch of negotiations of an RTA; (ii) inform other members of the signature of an agreement and (iii) formally notify an RTA immediately upon ratification. Thus, other members become aware of and can track an RTA’s progress from start to finish. The transparency agreement also requires notification to the WTO of changes in implementation or operation of an RTA that occur after the original notification. Information flow is improved by the transparency agreement as it lays out the information that must be provided in notifications including tariff-line data on concessions made in the agreement, trade volume data, rule of origin formulations, etc. Additionally, the dispute settlement awareness problem is partially resolved because factual reports are now prepared by the WTO Secretariat in consultation with the relevant parties.\(^\text{30}\)

While this transparency agreement is a potentially useful step forward, it does not resolve any of the substantive differences over key terms in Article XXIV. Moreover, it must be kept in mind that implementation of the transparency agreement is still dependent on the good faith of members (as well as enhanced peer pressure) for compliance and that, generally, there are not any significant penalties for failing to comply with notification/transparency obligations (as many countries have found out with notification obligations in other WTO agreements).

b. Substantive/Systemic proposals. Government proposals on substantive or systemic issues have generally focused on clarifying the term ‘substantially all’ trade (and the related issues of ‘other regulations of commerce’ and ‘other restrictive regulations of commerce’). As regards the issue of ‘substantially all’ trade, members are still in discussions as to whether to use a trade

---

29. Proposals submitted by the governments during the negotiations included the following: (i) notification in advance of RTA texts being finalized or ratified; (ii) providing information not just on a trade flow basis, as is currently done, but also a tariff line basis; (iii) biennial reporting on implementation of RTAs; (iv) having the WTO Secretariat or independent groups of experts prepare the factual reports on RTAs and (v) clarifying the legal status of factual examination reports (so as to end virtual paralysis in adopting such reports and perhaps eliminate the ‘dispute settlement awareness’ problem).

volume-based test or a tariff-line based test or some combination of the two. The problem with a pure tariff-line based test is that parties to an RTA could liberalize a very high percentage of tariff lines but still not liberalize a high percentage of trade if the tariff lines they refuse to liberalize currently constitute a large percentage of the trade between the countries to the RTA. The problem with a pure trade-based test is that trade volumes can fluctuate (and thus an agreement’s consistency under a trade-based test might fluctuate as well).\(^\text{31}\) A trade-based test might also allow countries to an RTA to exclude many tariff lines from liberalization that currently do not have much trade but might in the future were tariffs to be lowered.\(^\text{32}\) Thus, many countries are leaning towards some sort of combined test, particularly those interested in curing the agriculture-exclusion problem riddling many current RTAs. For example, Australia, a significant agricultural exporter, has proposed a type of combined test.\(^\text{33}\) Australia’s submission suggests that at least 70% of tariff lines be liberalized immediately upon entry into force of an RTA and that 95% of tariff lines be fully liberalized within ten years of conclusion of an RTA. To address, the problem of a few tariff lines with high trade volumes being excluded, Australia would supplement its tariff line approach with a requirement that the top 50 tariff lines in terms of trade volume be included in the duty elimination under the RTA or that any tariff line that constituted 0.2% of total imports be included in the liberalization.

Other countries are not satisfied with a pure quantitative test and want to at least supplement any quantitative test with qualitative factors. For example, Japan proposed that the following qualitative factors be considered: (i) the exclusion of any major sector (although the combined quantitative test of Australia would do a good job of ensuring this does not occur in an RTA); (ii) the influence of trade remedy measures; (iii) the extent of tariff reduction; (iv) an assessment of tariff rate quotas and (v) tariff elimination with long implementation periods.\(^\text{34}\) These qualitative factors obviously tie into other issues such as what constitutes ‘other regulations of commerce’ and the ‘reasonable period of time’ to implement an interim agreement leading to an RTA. The European Union also favors a qualitative as well as quantitative assessment of RTAs adding a few other factors that might be considered, including special safeguards in RTAs and seasonal restrictions on products.\(^\text{35}\) However, qualitative factors might lead to the same ambiguity regarding the consistency of the RTAs with WTO disciplines as occurs today and some

\(^{31}\) See, e.g. the Japanese submission, WTO Doc. TN/RL/W/190, 28 October 2005.
\(^{32}\) See ibid.
\(^{34}\) See WTO Doc. TN/RL/W/190, 28 October 2005.
countries may be suggesting such factors to keep the ‘waters muddy’ and protect non-robust RTAs from challenge.

With respect to clarifying the term ‘other regulations of commerce’, India has proposed that it be explicitly agreed that RTA rules of origin fall within the term ‘other regulations of commerce’. India’s proposal also suggests a requirement that RTA rules of origin be no more restrictive than the most liberal GSP scheme operated by any country member to the RTA. Very few, if any, RTAs, would currently comply with such a condition so one can imagine the distance that still needs to be bridged in the negotiations on this issue.

Perhaps unsurprisingly, given the variations in RTAs, not much compromise or consensus has been achieved on substantive and systemic issues to control RTAs. No draft consensus text has been prepared; indeed, governments have even been reluctant to submit text-based proposals.

c. ‘Grandfathering’ issue. Some countries, including the European Union, suggested early in the negotiations that existing RTAs should be ‘grandfathered’, i.e. exempted from any new constraints developed in the course of negotiations. This should be strongly resisted for several reasons. First, it could affect the second avenue to strengthening constraints within the WTO system, namely, it may, depending on how phrased, directly or indirectly affect the ability of a WTO member to successfully challenge an existing RTA in the WTO dispute settlement system. Second, to the extent new substantive constraints only impact or deter future RTAs, those constraints may lock in place a worse state of affairs than would exist with further regional activity for, as noted above, some of the broader regional initiatives currently underway may actually help reduce the existing spaghetti bowl effect. Third, as China pointed out in its submission, grandfathering of existing RTAs would discriminate against countries only recently entering into RTA activity.

2. WTO dispute settlement system

The Uruguay Round Understanding on Article XXIV eliminated the uncertainty that existed within the GATT system over whether challenges to RTAs within the dispute settlement system were possible by explicitly de-

36. More recently, the EU has stated that ‘any future clarifications would have to take into account such variations in approaches by Members, while going beyond lowest common denominator’. WTO Doc. TN/RL/W/179, 12 May 2005.
37. WTO Doc. TN/RL/W/179.
38. Under the GATT, there was only one case brought against an RTA within the dispute settlement system. ‘In the early 1980s, the United States complained of a series of regional agreements concluded between the EC and Mediterranean countries because they lacked a plan or schedule for completion within a reasonable time and were not reciprocal in some aspects. After a long delay in the proceedings, the panel issued a report in 1985 in which it said that it
claring that the dispute settlement system is open to such challenges. Indeed, the Appellate Body stated (or at least very strongly hinted) in the 2000 Turkey Textiles case that they would examine the conformity of an RTA with the internal and external requirements of Article XXIV if presented with such a claim. Additionally, GATT/WTO jurisprudence does not recognize the concept of latches (i.e. a long delay in challenging an RTA does not lead to a presumption of conformity of the RTA with Article XXIV). Therefore, a case against an RTA is a legal possibility. However, whether such a case becomes a reality depends on several factors. While at least some lawyers in the DC trade bar believe that a government could successfully pursue an RTA challenge, bringing such a case carries several risks. First, because nearly all WTO members are party to a RTA and the standards for reviewing conformity are so broad and imprecise, most members will see at least some defensive interests on the issue. Second, potential plaintiffs will need to consider the interaction between the negotiations and an on-going dispute settlement case. If negotiations on RTAs within the Doha Round are leading to nothing fruitful, then a dispute settlement case might be the only hope for moving towards tangible constraints. It is a strategy not without risk, however, because if a case fails, then there will be even less motivation in the negotiations. Third, there is some institutional risk to the Appellate Body being viewed as ‘law

would not review the conformity of the agreements with GATT Art. XXIV because this could only be done within Art. XXIV’s review proceedings. However, the panel seemed to accept a so-called non-violation nullification and impairment argument by the United States and so the EC blocked adoption of the report. After a series of retaliatory actions, a settlement was negotiated in 1986 in which the US pledged no further legal challenges in exchange for reduction in orange and lemon tariffs. Robert Hudec, Enforcing International Trade Law (1993). Note that the Bananas I (1991) and Bananas II (1994) GATT panels (both leading to unadopted reports) also apparently faced Article XXIV defense issues being raised at the margins of the dispute.

39. The WTO Appellate Body has examined Article XXIV’s RTA provisions in the 2000 Turkey Textiles case. See Appellate Body Report, Turkey--Restrictions on Imports of Textile and Clothing Products, WTO Doc. WT/DS34/AB/R, adopted 19 November 1999. Turkey imposed quantitative restrictions on Indian textiles because otherwise the EU would not have agreed to include textiles in its RTA with Turkey. (Turkey indicated that if textiles were not included in the RTA, then the RTA would not meet the requirement of liberalizing substantially all trade since such a large amount of EU-Turkey trade is in textiles). However, the Appellate Body did not examine whether the EU-Turkey RTA met the internal (substantially all) and external (barriers not on the whole higher or more restrictive) requirements of Art. XXIV because India did not present such a claim. Rather, the AB only decided that the QRs were not necessary, or more specifically that their absence would not have ‘prevented’ the formation of a CU between the EU and Turkey, since a certificate of origin scheme would have been a satisfactory alternative to prevent Indian textiles from being transshipped into the EU under the EU-Turkey RTA.

40. See, e.g. panel report in Turkey--Restrictions on Imports of Textile and Clothing Products, WTO Doc. WT/DS34/R, 31 May 1999 (stating that ‘it would be erroneous to interpret the fact that a measure has not been subject to Art. XXIII over a number of years as tantamount to tacit acceptance by the contracting parties’).
making’ given the broad, imprecise language such a claim would be based upon (similar to the controversy surrounding the Appellate Body’s rulings in the area of amicus briefs). Indeed, while the Appellate Body does not like to backtrack, it is possible that they would use a tool of judicial restraint to avoid actually directly addressing a complaint of this nature.

Beyond these general considerations, the most likely plaintiff countries seem to have somewhat mixed interests in pursuing such a case. The countries historically most opposed to increased RTA activity (Japan, Korea, Singapore and Hong Kong), and most likely to be plaintiffs for systemic reasons, are now negotiating and concluding RTAs themselves (signaling a ‘if you cannot beat them, join them’ mentality). One potential claim that might be made in a challenge to an RTA is that its failure to liberalize a major sector such as agriculture runs afoul of the ‘substantially all’ criteria for internal liberalization. However, Japan and Korea are defensive on agriculture issues and unlikely to make that particular challenge. Indeed, Japan is having trouble making rapid progress in its RTA negotiations due to its agricultural sensitivities. Korea’s paper on RTAs in the Doha Round suggests it has many concerns with RTAs but it is unclear that they would choose to go the dispute settlement route (at least until progress in the negotiations can be more clearly assessed).

The United States is another potential plaintiff. As evidenced by the 1980s challenge to the Euro-Med agreements (EC agreements with Mediterranean countries), a complaint by the United States against an RTA has been taken in the past and continues to be a possibility in the future. An EU RTA would be the likely target of any such case as the United States would surely not want to challenge a Latin American RTA for fear of further harming possibilities of reviving FTAA negotiations at some point in the future. However, the overall status of EU–US relations and some fatigue with other controversial cases suggests that another explosive case, such as an RTA complaint, is likely not in the cards in the near future either.

Australia (or another Cairns group member) is another possible plaintiff. Traditionally, it was thought third country agricultural exporters had no interest in challenging agricultural-exclusions within RTAs (in essence asking to be subject to negative preference margins) but the impact of the large


43. As a sign that the EU is aware of their potential exposure to such a claim, they tried at the very end of the Uruguay Round negotiations in December 1993 to have the Art. XXIV Understanding’s provisions on dispute settlement deleted.
ber of agricultural-excluded RTAs on multilateral liberalization (and/or the view that any RTA-induced agricultural reforms may eventually benefit or expand to third countries) may change this traditional calculation, although to date it has not.

III. EFFORTS THE US CAN UNDERTAKE UNILATERALLY OR REGIONALLY TO ENSURE RTAS COMPLEMENT MULTILATERALISM

With fairly wide disagreement within the WTO negotiations as to how to ensure that RTAs complement the WTO system, and no plaintiff yet willing to step forward within WTO dispute settlement system to challenge the broad legality of an RTA, the question is left as to what actions the United States, as the largest economy in the world and with much negotiating leverage, could take to ensure that at least its own growing regionalism complements the WTO system. Specifically, the question is whether the United States has tools at its disposal as it pursues its regional agenda to ensure that other countries it partners with maintain an incentive to be forthcoming and cooperative in the WTO negotiations and that its RTAs are not overly trade diverting. In fact, there are a series of measures the United States could take unilaterally or in cooperation with their RTA partners using its negotiating leverage to minimize the harmful effects of regionalism on the WTO system, some of which the United States is already undertaking but that could be further emphasized. These measures include the following:

* Explore the possibility of including obligations, not just preambular language, in RTAs requiring WTO partner countries to cooperate positively within WTO negotiations, not just on specific issues but also more generally. While it might be hard to enforce such an obligation, it would certainly provide further negotiating leverage within the WTO when the United States asks for cooperation on progress in the WTO from an RTA partner country.

* Emphasize in broader diplomatic discussions with potential RTA partner countries, the need for those countries to participate actively and positively in WTO negotiations, and continue to make WTO membership and cooperation a condition of launching RTA negotiations with a given country.

---

44. Article 3.16 of the US-Chile FTA is an example of where the parties pledge to cooperate in the WTO negotiations on a specific issue area, namely agricultural export subsidies disciplines.

45. For example, apparently, the US was originally hesitant about ‘docking’ the Dominican Republic to the FTA with Central American countries because of positions the Dominican Republic was taking within WTO negotiations.
* Explore the possibility of linking, either explicitly or de facto, RTA tariff cut accelerations (that reduce the amount of time it takes under an RTA to fully eliminate tariffs on a given product) to progress/concrete results in the WTO multilateral negotiations. In other words, say to RTA partners ‘you keep your preference margins for the same amount of time even if you are forthcoming and cooperative in multilateral negotiations because we will reduce the preferential rate under the RTA faster as you cooperate to reduce MFN rates faster within the WTO’.46

* Continuing to explore and negotiate sectoral customs unions (i.e. harmonize the tariffs charged to third countries) with RTA partners. Sectoral customs unions reduce the problems and costs associated with applying rules of origin. The United States already has a sectoral custom union with Canada on computers and, given the similarity in MFN rates between the two countries, other sectoral customs unions are possible.47

* Continuing to liberalize rules of origin within existing RTAs where possible (e.g. as was done in 2002 and again in 2006 within NAFTA).

* Maintain and improve the high standards of trade coverage in the RTAs it concludes so as to minimize any defensive interests it has with respect to RTAs as regards WTO-compliance but continue to resist exempting RTA partner countries from US anti-dumping law.

It is important to realize that some of these measures are potentially politically difficult, such as tariff accelerations and rule of origin liberalization, depending on what products are involved. Additionally, unlike WTO efforts, these US unilateral efforts cannot ‘clean-up’ or make more robust those RTAs to which it is not a party. Thus, these US efforts must be viewed as a supplement, rather than a replacement, for efforts within the WTO to improve disciplines on RTAs. However, these US efforts could potentially have a more immediate impact than efforts within the WTO.

IV. CONCLUSION

RTA activity by the United States and even other countries traditionally opposed to regionalism has rapidly expanded in the past decade. This trend is unlikely to be halted as political and diplomatic considerations will re-

46. Of course, there is already some linkage between the broad regional (but now stalled) FTAA negotiations and the Doha negotiations being demanded by countries such as Brazil that may drive these two negotiations to be concluded at or around the same time. Brazil wants agricultural subsidies issues and anti-dumping issues addressed prior to concluding the FTAA negotiations and the U.S. has made clear that these two issues can only (or largely) be addressed within the WTO negotiations.

quire future FTAs even if the WTO negotiations process for further multi-
lateral liberalization is reinvigorated. Proponents of the WTO system have
concerns that this RTA activity, as currently structured, may not be fulfill-
ing the original economic conditions creating the basis for the exception
in the WTO system for RTAs. Specifically, there is much concern over the
exclusion of agriculture from many RTAs, the use of highly complex and
restrictive rules of origin within RTAs, and the varied treatment of trade
remedies within RTAs. While the WTO has two mechanisms to cure these
controversies, specifically its negotiating rounds and dispute settlement sys-
tem, doubts exist as to how much progress can be made utilizing these two
mechanisms. As a result, and somewhat ironically, US unilateral efforts and
use of US negotiating leverage with its RTA partners may be, at the very
least, a necessary supplement to efforts in the WTO to ensure that RTAs are
complementing the WTO system.