# FREE TRADE AGREEMENTS
## A NEW VISION FOR UK TRADE

Lode Van Den Hende and Jennifer Paterson of Herbert Smith Freehills LLP look at reciprocal free trade agreements and the related World Trade Organization rules.

The government has announced that it intends the UK to become a "global Britain" following its exit from the EU, with the negotiation and conclusion of new free trade agreements (FTAs) with third countries high on the UK's agenda. This vision was also confirmed in the Brexit White Paper published on 2 February 2017, and the government's response published on 28 February 2017 (*see Opinion article "Financial services after Brexit: possible cross-border models", www.practicallaw.com/7-639-3111; www.parliament.uk/documents/lords-committees/eu-external-affairs-subcommittee/Future-trade-EU-UK-Government-Response-and-Annex%20A.pdf*). Countries mentioned as potential trade partners with the UK include the US, Canada, Australia, the People's Republic of China, Brazil and the Gulf states.

This article outlines the basics of reciprocal FTAs and the World Trade Organization (WTO) rules applicable to these agreements. Since the UK is a WTO member in its own right and will continue to be following its exit from the EU, WTO rules will be relevant to any FTAs that it concludes. This article does not specifically consider issues that might arise in relation to a UK FTA with the EU.

### THE BASICS OF FTAS

FTAs contain rules regarding the conduct of trade policy and seek to remove or reduce barriers to trade on a reciprocal basis. These agreements may be bilateral in nature or between a number of trading partners.

In recent years, the number of FTAs in force has risen exponentially. While there were only about 50 FTAs in force in 1990, as of 1 September 2016, the number of FTAs in force between WTO members had risen to over 260. The increased importance of FTAs is due, in part, to the fact that further trade liberalisation has not been achieved in the context of multilateral WTO negotiations. As a consequence, countries have opted to seek freer trade through more targeted FTA arrangements.

While the term "free" trade agreement could be understood to imply unrestricted trade, in fact, FTAs can involve many different levels of trade liberalisation and integration. FTAs do not usually secure free trade in the strictest sense, such as that which may occur within a sovereign state. Rather, FTAs commonly aim at "freer" trade, most notably by incorporating and going beyond the rules of the WTO.

#### Type of FTA

FTAs may cover trade in goods or trade in services, or both. Before the WTO was established in 1995, the trend was for most FTAs to address only trade in goods. There were exceptions to this rule, however, most notably with respect to the EU. Since the establishment of the WTO, trade in services has become an established part of FTAs.

**Trade in goods.** At their most basic level, the trade in goods aspects of FTAs have as a key goal the elimination of all, or nearly all, tariffs on trade in industrial goods. They also aim to eliminate discrimination and other border

measures that impede trade, such as import quotas. Accompanying these basic trade rules are numerous provisions designed to ensure that market access achieved through the elimination of tariffs and quantitative restrictions is not undermined by other border-related procedures.

Therefore, trade in goods FTAs will normally contain provisions on, among other things, rules of origin and other customs matters. They will also address the use of trade defence instruments, such as anti-dumping duties and safeguard measures. Other rules are also typically included in order to help ensure that market access achieved for trade in goods is not unduly undermined by domestic measures. Among other things, trade in goods FTAs will generally contain basic rules prohibiting the unnecessary regulation of products (so-called technical barriers to trade) and food safety and animal and plant health measures (so-called sanitary and phytosanitary measures).

**Trade in services.** Trade in services FTAs target, at their most fundamental level, market access, discrimination and certain aspects of domestic regulation. Unlike trade in goods FTAs, most trade in services FTAs do not aspire to provide access in principle for most or all trade in services at their entry into force or shortly thereafter. Rather, they will normally liberalise trade in services on either an opt-in or opt-out basis and prohibit new discriminatory measures.

Where an opt-in approach is applied, trade in services is, in principle, liberalised for the sectors and methods of service delivery identified. Where an opt-out approach is identified, trade in services is, in principle, liberalised for all services and modes of delivery, subject to specifically identified exclusions, which can be extensive.

Modern FTAs, and especially those between developed countries, tend to follow the opt-out approach. Like rules regarding trade in services established at the WTO level, FTAs will also contain specific rules or chapters for certain service sectors, such as financial services and telecommunications. Broadly, the trade in services provisions are aimed at providing access which is overall greater than under the WTO. However, whether this is the case for any particular service or service provider has to be assessed on a case-by-case basis. In addition, it may be that the liberalisation of a sector under an FTA as compared to the WTO is not significantly greater; for example, one or two more financial services may be authorised on a cross-border basis.

## WTO weblinks

**General Agreement on Tariffs and Trade (GATT)**
www.wto.org/english/docs_e/legal_e/gatt47_e.pdf

**General Agreement on Trade in Services (GATS)**
www.wto.org/english/docs_e/legal_e/26-gats_01_e.htm

**WTO Understanding on the Interpretation of Article XXIV of the GATT 1994**
www.wto.org/english/docs_e/legal_e/10-24_e.htm

**Differential and more favourable treatment reciprocity and fuller participation of developing countries, Decision on 28 November 1979 (the enabling clause)**
www.wto.org/english/docs_e/legal_e/enabling1979_e.htm

**2006 Transparency Mechanism for Regional Trade Agreements (the transparency mechanism)**
www.wto.org/english/tratop_e/region_e/trans_mecha_e.htm

**1996 WTO decision establishing the Committee on Regional Trade Agreements**
www.wto.org/english/tratop_e/region_e/regcom_e.htm

**WTO Report of the Appellate Body: Turkey – Restrictions on imports of textile and clothing products**
www.wto.org/english/tratop_e/dispu_e/cases_e/ds34_e.htm

**WTO Agreement on Technical Barriers to Trade**
www.wto.org/english/tratop_e/tbt_e/tbt_e.htm

### Other features of FTAs

Beyond containing basic trade rules, FTAs may also seek to address a range of other issues including matters relating to intellectual property, subsidies, post-establishment investment protection, labour, e-commerce and sustainable development (*see box "FTA example"*). Another important feature of FTAs is dispute settlement and, where investment provisions are included, investment arbitration. Dispute settlement involves state-to-state litigation mechanisms, whereas investment arbitration allows claims to be brought by private persons against a state.

Newer generation FTAs also increasingly tackle trade barriers that arise as a result of differences in justified domestic regulation, that is, regulatory measures that are not discriminatory or otherwise overly restrictive when assessed in light of basic trade rules; for example, certain product regulations motivated by public health or environmental concerns. There are various ways to address these types of barriers, such as through harmonisation, equivalence and mutual recognition provisions.

**Harmonisation.** Harmonisation involves the drawing up of common or identical rules with the intention that the mandatory rules governing a product or service will be the same among the FTA parties. Harmonisation is a fundamental feature of the EU and important in relation to other countries that have deeper integration agreements, for example, European Free Trade Association countries in the context of the EEA. However, extensive harmonisation provisions are not included in most FTA arrangements. Where FTAs do include harmonisation provisions, they are often piecemeal or persuasive in character. The EU-South Korea FTA provides an example of relatively strong, but narrowly defined, harmonisation provisions. Although harmonisation is not automatic for all standards, the EU-South Korea FTA requires parties to harmonise automotive sector regulations with certain UN regulations unless a party demonstrates that it would be ineffective or inappropriate to achieve its objectives.

**Equivalence.** Equivalence means that FTA parties recognise that, even though different, their domestic regulations fulfil similar

regulatory objectives. They agree to accept compliance with the domestic regulation of another party as equivalent to their own and allow market access on that basis. Therefore, for example, a product fulfilling the standard of one party can be placed on the market of a different party as though it conformed to the rules in force there. For example, the Singapore-Australia FTA provides for the equivalence of certain food standards provided that the exporting party objectively demonstrates to the importing party that its food regulations achieve the purposes of the importing party's regulations for food products.

**Mutual recognition.** Mutual recognition differs depending on whether it is used in relation to trade in goods or trade in services. In the trade in goods context, the term refers to mutual recognition of conformity assessments of regulated products. In relation to trade in services, mutual recognition normally means that FTA parties recognise the adequacy of the other's regulation or supervision of an activity or institution as a substitute for its own; the term "equivalence" is also used. Traders that comply with the applicable home state rules may therefore access the host state under an exemption from some or all of the host state's rules. While mutual recognition is normally addressed in FTAs, mutual recognition is also often the subject of standalone international arrangements.

## THE WTO DIMENSION

WTO rules pertaining to trade in goods and trade in services require all WTO members to be treated equally and, more specifically, for trade preferences granted to one country to be extended to all other WTO members; for example, in Article I of the General Agreement on Tariffs and Trade (GATT) and Article II of the General Agreement on Trade in Services (GATS) (*see box "WTO weblinks"*). This is called most-favoured-nation (MFN) treatment. Any discrimination that does not respect this principle is commonly referred to as MFN discrimination.

The liberalisation brought about by FTAs, such as reduced tariffs, may result in MFN discrimination against other WTO members. However, the WTO recognises that FTAs can have positive effects, such as by contributing to the expansion of world trade due to closer integration between the economies of the FTA parties (*recital to the WTO Understanding on the Interpretation of Article XXIV of the GATT 1994*) (WTO Understanding). WTO rules therefore permit FTAs and related arrangements in certain defined circumstances (*see box "Other trade-related arrangements"*). The key rules are described in this section.

### Article XXIV of GATT

Article XXIV of GATT (Article XXIV) contains provisions that are applicable to the trade in goods aspect of FTAs. Under Article XXIV, FTAs that result in either free trade areas or customs unions (or interim agreements necessary for their formation) are not prohibited as long as they conform to certain stipulated requirements (*see box "Interim agreements"*).

Paragraph 4 of Article XXIV identifies in general terms the purposes that free trade areas and customs unions should fulfil in relation to trade between the contracting parties and in relation to trade with other WTO members. Their purpose should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other WTO members with the FTA parties. The WTO Appellate Body has stated that paragraph 4 of Article XXIV is not a separate obligation but, rather, sets forth the overriding and pervasive purpose for Article XXIV which is manifested in operative language in the specific obligations that are found elsewhere in Article XXIV (*paragraph 57, WTO Report of the Appellate Body: Turkey – Restrictions on imports of textile and clothing products, 22 October 1999*) (1999 WTO Appellate Body report).

### Other trade-related arrangements

The World Trade Organization (WTO) also recognises the ability to enter into certain other more narrow trade-related arrangements. These concern, in particular, arrangements on mutual recognition, equivalence and labour integration. Where these arrangements exist independently of a customs union or free trade area type of free trade agreement (or an agreement covered by the enabling clause), the resulting agreement does not have to fulfil the requirements relating to a customs union or free trade area in order to be WTO-compliant (*see "Enabling clause" in the main text*). For example:

- Article VII of the General Agreement on Trade in Services (GATS) permits WTO members, for the purposes of the fulfilment, in whole or in part, of its standards or criteria for the authorisation, licensing or certification of service suppliers, to recognise the education or experience obtained, requirements met, or licenses or certifications granted in a particular country. Adequate opportunity for other interested WTO members to negotiate their accession to such an agreement or arrangement or to negotiate comparable ones with it must be provided. In addition, recognition cannot be provided in a manner which would constitute a means of discrimination between countries in the application of the WTO member's standards or criteria for the authorisation, licensing or certification of services suppliers, or a disguised restriction on trade in services.

- Paragraph 3 of the Annex on Financial Services to GATS permits WTO members to recognise prudential measures of any other country in determining how that member's measures relating to financial services will be applied. Adequate opportunity must be provided for other interested members to negotiate their accession to such agreements or arrangements, or to negotiate comparable ones with it, under circumstances in which there would be equivalent regulation, oversight, implementation of such regulation and, if appropriate, procedures concerning the sharing of information between the parties to the agreement or arrangement.

- Article V bis of GATS authorises certain agreements establishing full integration of labour markets.

- Article 6.3 of the Agreement on Technical Barriers to Trade encourages WTO members, at the request of other members, to be willing to enter into negotiations for the conclusion of agreements for the mutual recognition of results of each other's conformity assessment procedures.

## Interim agreements

Article XXIV of the General Agreement on Tariffs and Trade (Article XXIV) authorises interim agreements that lead to the formation of a customs union or free trade area when they satisfy certain requirements regarding the impact on other World Trade Organization (WTO) members. Any interim agreement must include a plan and schedule for the formation of a free trade area or customs union within a reasonable period of time (*paragraph 5(c), Article XXIV*). The reasonable period of time should exceed ten years only in exceptional cases (*WTO Understanding on the Interpretation of Article XXIV of the GATT 1994*). In practice, most WTO members do not notify their free trade agreements as interim agreements.

### Free trade areas

If an FTA results in a free trade area, or an interim agreement leading to the formation of a free trade area, it can be permissible despite the MFN obligations (for example, in Article I of GATT) if it satisfies certain stipulated requirements on the impact of the FTA on trade with other WTO Members (in paragraphs 5 to 9 of Article XXIV of GATT). This is, however, technically subject to paragraph 10 of Article XXIV, which stipulates that the contracting parties may approve, by a two-thirds majority, proposals that do not fully comply with the requirements of paragraphs 5 to 9 of Article XXIV, provided that these proposals lead to the formation of a customs union or a free trade area.

**Free trade area definition.** Paragraph 8(b) of Article XXIV defines a free trade area as a group of two or more customs territories in which the duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX of GATT) are eliminated on substantially all the trade in products originating in these territories.

The provisions set out in Articles XI, XII, XIII, XIV, XV and XX of GATT relate to exceptions to the application of GATT. Paragraph 8(b) of Article XXIV therefore suggests that these measures are permitted while the remaining duties and other restrictive regulations of commerce must be eliminated with respect to substantially all the trade in originating products.

There have been many differences of opinion in the WTO regarding how the term "substantially all the trade" should be interpreted. Both quantitative and qualitative approaches have been advocated. The quantitative approach measures the percentage of duty-free tariff lines that countries offer or the percentage of trade that is made duty free. A qualitative approach refers to conditions to be applied so that no major sector is left out of liberalisation.

The preamble to the WTO Understanding makes reference to this qualitative element, suggesting that the possibility for an agreement to extend to substantially all trade is diminished where major economic sectors are omitted. The WTO Appellate Body has stated that "substantially all the trade" is not the same as all the trade but is something considerably more than merely some of the trade; however, it gives no definitive guidance on the interpretation of the term (*paragraph 48, 1999 WTO Appellate Body report*). In practice, many different approaches are followed. For example, it is not uncommon to exclude agriculture from FTAs and duties may be reduced by 90% of collective tariff lines (as opposed to 100%), especially where an FTA between a developed and a developing country is involved.

Paragraph 8(b) of Article XXIV also refers to the elimination of duties and other restrictive regulations of commerce. The word "duties" is relatively straightforward. The term "restrictive regulations of commerce" is generally understood to mean non-tariff barriers.

**Impact on other WTO members.** Under paragraph 5(b) of Article XXIV, the duties and other regulations of commerce maintained by free trade area parties and applied by WTO members not party to the FTA must not be higher or more restrictive than the corresponding duties and other regulations of commerce which existed in the free trade area territories before the formation of the free trade area, or interim agreement as the case may be.

This requirement seeks to ensure that free trade areas do not raise barriers to trade with other WTO members. In effect, it prohibits a free trade area WTO member from increasing tariffs on one or more products for other WTO members (even if otherwise permitted by WTO rules) in order to compensate for duty-free access granted under an FTA.

### Customs unions

If an FTA results in a customs union, or an interim agreement leading to the formation of a customs union, it can be permissible despite the MFN obligations if it satisfies certain stipulated requirements as to the impact of the FTA on other WTO members. However, as with free trade areas, this is technically subject to paragraph 10 of Article XXIV, which stipulates that the contracting parties may approve, by a two-thirds majority, proposals that do not fully comply with the requirements of paragraphs 5 to 9 of Article XXIV, provided that these proposals lead to the formation of a customs union or a free trade area.

**Customs union definition.** Paragraph 8(a) of Article XXIV defines a customs union as the substitution of a single customs territory for two or more customs territories so that:

- Duties and other restrictive regulations of commerce (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 or at least with respect to substantially all the trade in products originating in these territories.

- Substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union.

The first part of this requirement follows the basic requirements pertaining to the definition of a free trade area (*see "Free trade areas" above*). The second part of the requirement requires a common external tariff and trade policy. The word "substantially" implies that duties and regulations of commerce need not all be the same. The WTO Appellate Body has indicated that: there is a certain degree of flexibility in the provision; something closely approximating to sameness is required; comparable trade regulations having similar effects are not sufficient; and the criterion has both quantitative and qualitative aspects (*paragraphs 49-50, 1999 WTO Appellate Body report*).

## FTA example

The recently signed EU-Canada free trade agreement (FTA) (known as the EU-Canada Comprehensive Economic and Free Trade Agreement (CETA)) provides an example of the wide range of matters that can be addressed by an FTA. Chapters, protocols and annexes covered by the FTA (comprising more than 1500 pages) relate to, among other things, the following:

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| National treatment non-discrimination, that is, less favourable treatment of Canadian goods as compared to EU goods is prohibited. | International maritime transport services, for example, measures to ensure fair and equal access to ports and port services for commercial ships. |
| Tariff elimination and prohibitions on import and export restrictions, for example, there are commitments to reduce tariffs on most goods from the other party on the entry into force of the FTA. | Financial services, with provisions concerning areas such as discrimination, market access and creating a financial services committee to, among other things, oversee the implementation of the FTA. |
| Rules of origin, that is, rules are set out to determine when a good should be considered to originate from the other party and therefore receive the benefits of the FTA. | Electronic commerce, for example, measures protecting personal information on the internet and measures ensuring that online services remain free from customs duties. |
| Trade remedies, containing provisions that affirm World Trade Organization rights to impose anti-dumping, anti-subsidy and safeguard measures. | Competition policy, with provisions to ensure that both jurisdictions act fairly and transparently when pursuing competition law remedies against their own or the other party's companies. |
| Mutual recognition of professional qualifications, establishing a framework to facilitate the mutual recognition of qualifications in regulated professions such as architects, accountants and engineers. | Telecommunications, with provisions to ensure that businesses are granted access to public telecommunications networks and provisions in relation to customers receiving telecommunication services. |
| Government procurement, containing provisions governing the areas in which businesses can provide services to the other party's government, as well as specific rules that must be met on the nature of the goods, the value of goods and identity of the customer. | State enterprises, monopolies and enterprises granted special rights or privileges, including provisions that regulate state-owned enterprises and monopolies to ensure that they do not discriminate against companies resident in the other jurisdiction. |
| Customs and trade facilitation, containing provisions that aim to streamline customs procedures and make them more efficient. | Intellectual property (IP), including rules that outline the procedures necessary to protect against IP violations and how IP violations can be enforced. |
| Sanitary and phytosanitary measures, with provisions that seek to ensure that measures by either side to ensure food safety and animal and plant health do not create unjustified barriers to trade and that address when another party's measure must be accepted as equivalent. | Temporary entry and stay of natural persons for business purposes, with provisions that provide legal certainty for trained workers who enter the EU or Canada to do business and that cover the sectors these professionals can operate in and the maximum length of their stay. |
| Subsidies, which includes provisions to encourage transparency around government subsidies to companies. | Regulatory co-operation, with provisions that encourage increased co-operation while maintaining that co-operation is voluntary as regulators maintain their legislative powers. |
| Investment, including protection for investors and the creation of a novel investment tribunal with appellate procedures . | Domestic regulation, with provisions ensuring that regulations are transparent. |
| Cross-border trade in services, with provisions prohibiting discrimination and certain market access measures, subject to exclusions listed in the FTA. | Trade and sustainable development, for example, establishing a joint committee on trade and sustainable development, and requiring transparency in order to promote public participation with sustainable development. |
| Trade and labour, including provisions that protect each jurisdiction's right to regulate in relation to labour but also stipulating that each side should maintain current labour standards as a minimum. | Trade and environment, with provisions requiring both parties to implement international environmental agreements, for example, in relation to forest, fisheries and aquaculture products. |
| Technical barriers to trade, with rules that address: the preparation, adoption and application of technical regulations, standards and conformity assessment procedures; commitments to work more closely on technical regulations for testing and certifying products; and an agreement to accept each other's conformity assessment certificates in areas such as electrical goods, electronic and radio equipment, toys, machinery and measuring equipment. | Dispute settlement, for example, provisions on mediation, establishment of arbitration and compliance with arbitral reports. |

The requirement for a common external tariff and trade policy is the chief reason why the UK does not want to form a customs union with the EU. In principle, the requirement for a common external trade policy would prevent the UK from entering into FTAs independent from the EU. Presumably, the UK will also not want to form customs unions with other trade partners.

**Impact on other WTO members.** Under paragraph 5(a) of Article XXIV, the duties and other regulations of commerce imposed at the institution of any customs union in respect of other WTO members not party to the FTA customs union must not, on the whole, be higher or more restrictive than the general incidence of duties and regulations of commerce applicable in the constituent territories before the formation of the union or the adoption of the interim agreement. Therefore, like for free trade areas, Article XXIV imposes a standard to ensure that the formation of a customs union does not raise barriers to trade with other WTO members.

In practice, the requirement in paragraph 5(a) of Article XXIV means that, for the purpose of aligning their external trade policy, customs union FTA parties cannot do this in such a way that duties or other regulations of commerce are generally higher than before the creation of the customs union.

Paragraph 2 of the WTO Understanding provides that the evaluation of the general incidence of the duties and other regulations of commerce applicable before and after the formation of a customs union must, in respect of duties and charges, be based on an overall assessment of weighted average tariff rates and of customs duties collected and, for this purpose, the duties and charges to be taken into consideration must be applied rates of duties. In addition, for the purpose of the overall assessment of the incidence of other regulations of commerce for which quantification and aggregation are difficult, the examination of individual measures, regulations, products covered and trade flows affected may be required.

If, in forming a customs union, one or more parties increases any rate of duty above what is stipulated in their schedule of concessions, other WTO members can seek compensatory adjustment under Article XXVIII of GATT; for example, a lower tariff on a different good (*paragraph 6, Article XXIV*).

## Enabling clause

A 1979 WTO decision entitled "Differential and more favourable treatment reciprocity and fuller participation of developing countries", also known as the enabling clause, covers FTAs entered into by developing countries. The enabling clause allows developing countries to enter into FTAs that reduce or eliminate tariffs. This is unlike Article XXIV, which requires the elimination of tariffs on substantially all trade.

## Article V of GATS

FTAs liberalising trade in services are permitted when they meet requirements set out in Article V of GATS (Article V). Under paragraph 1 of Article V, in order to be permitted by GATS, FTAs concerning trade in services must:

- Have substantial sectoral coverage. Footnote 1 to GATS clarifies that this condition is understood in terms of number of sectors, volume of trade affected and modes of supply; that is, cross-border, consumption abroad, commercial presence and presence of natural persons. It also states that, in order to meet this condition, FTAs should not exclude any mode of supply.

- Provide for the absence or elimination of substantially all discrimination between or among the parties in the sectors covered. This must be done by eliminating existing discriminatory measures or prohibiting new or more discriminatory measures either at the entry into force of the FTA or on the basis of a reasonable timeframe, or both (although measures otherwise authorised under other GATS exceptions may continue to be applied). When evaluating the discrimination condition, consideration may be given to the relationship of the FTA to a wider process of economic integration or trade liberalisation among the countries concerned (*paragraph 2, Article V*).

Certain flexibilities are allowed in the case of FTAs involving developing countries (*paragraph 3, Article V*).

FTAs concerning trade in services must be designed to facilitate trade between the parties to the FTA and must not, in respect of any WTO member outside the FTA, raise the overall level of barriers to trade in services within the respective sector or subsectors compared to the level applicable before the FTA (*paragraph 4, Article V*).

Service suppliers of any other WTO member that is a legal person constituted under the laws of the party to an FTA covered by Article V are entitled to treatment granted under the FTA, provided that they engage in substantive business operations in the territory of the parties to the FTA (*paragraph 6, Article V*). Therefore, if the UK were to enter into a services FTA with the US, the benefits of the FTA would extend not only to UK or US companies owned by UK or US interests, but also to companies owned by other WTO members, as long as they have the requisite substantive business operations.

GATS operates largely on an opt-in basis. Key commitments in relation to market access and other trade matters are set out in schedules of specific commitments. As a result of joining an FTA concerning trade in services, it is possible that a WTO member will have to backtrack on its commitments; this is more likely to happen in deeper integration FTAs that involve harmonisation. If this happens, at least 90 days' advance notice must be provided and procedures for compensatory adjustment can be demanded (*paragraph 5, Article V*). In practice, this means that affected WTO members can request compensatory adjustment, such as liberalisation in other sectors, or, if justified, withdraw substantially equivalent benefits.

## Notification procedures

WTO rules require that FTAs be notified to the WTO (the WTO refers to FTAs as Regional Trade Agreements). Certain provisions of GATS relate to subsequent examination and consideration within the WTO (specific rules concerning, among other things, interim agreements and modification of FTAs are not discussed here although they largely mirror the general FTA procedures). The main rules are contained in Article XXIV and the WTO Understanding, Article V, the enabling clause (*see "Enabling clause" above*) and the 2006 Transparency Mechanism for Regional Trade Agreements (the transparency mechanism) (*see "Transparency mechanism" below*). Provisions of the 1996 WTO decision establishing the Committee on Regional Trade Agreements (CRTA) are also relevant.

GATS, GATT and the enabling clause, as interpreted in light of related relevant instruments, provide for the prompt notification of FTAs that fall within their scope and require WTO members to provide relevant information. They also establish that these FTAs are to be examined for consistency

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by the CRTA, which is then supposed to present a report to the Council for Trade in Services (CTS), the Council for Trade in Goods (CTG) and the Committee on Trade and Development.

Under Article V and Article XXIV the CTS and CTG, respectively, can make recommendations on the FTA which are considered appropriate. Under the enabling clause, the explicit goal is to reach mutually satisfactory solutions.

Although there are strong provisions for the examination of FTAs, the examination process has not worked in practice. Since the adoption of the WTO, no examination report has been adopted. The main reason for this has related to disagreement over the meaning of relevant substantive requirements. In addition, the rule of consensus for Article XXIV of GATT and Article V of GATS approvals has contributed to the stalemate.

### Transparency mechanism

Following negotiations, in 2006 WTO members agreed the transparency mechanism. The transparency mechanism contains procedures for the notification and provision of information on GATT, GATS and enabling clause FTAs as well as their consideration. The goal of the transparency mechanism is not to arrive at a conclusion regarding whether or not an FTA is WTO compliant; rather, it aims to increase transparency by providing objective information on the FTAs, therefore increasing the understanding of FTAs and their effects. Among other things, the transparency mechanism establishes the following:

- WTO members that are parties to a newly signed FTA are required to convey to the WTO, in so far as and when it is publicly available, information on the FTA including: its official name, scope and date of signature; any foreseen timetable for its entry into force or provisional application; relevant contact points and website addresses; and any other relevant unrestricted information.

- The notification of an FTA must take place as early as possible. As a rule, it will occur no later than directly following the parties' ratification of the FTA or any party's decision on application of the relevant parts of the FTA, and before the application of preferential treatment between the parties.

- Parties to the FTA submit specified data to the WTO. The data must usually be submitted within ten weeks of notification or 20 weeks in the case of FTAs involving only developing countries.

- The WTO Secretariat prepares a factual presentation of the FTA which refrains from any value judgment. Under the express terms of the transparency mechanism, it also cannot be used as a basis for dispute settlement procedures or create new rights or obligations for WTO members.

- As a rule, a single formal meeting will be devoted to consider each notified FTA and any additional exchange of information will take place in written form. The goal is for consideration by WTO members to be completed within one year of notification.

- At the end of an FTA's implementation period, parties are to submit to the WTO a short written report on the realisation of the liberalisation commitments in the RTA as originally notified.

### Dispute settlement and waivers

The mechanisms for the substantive examination of free trade areas, customs unions and GATS economic integration agreements by WTO members have not operated in practice. This does not mean, however, that review of notified FTAs cannot be obtained. Dispute settlement is in principle available to other WTO members to challenge the consistency of FTAs claiming to fulfil relevant criteria. Indeed, paragraph 12 of the WTO Understanding expressly stipulates that dispute settlement mechanisms may be invoked with respect to any matters arising from the application of the provisions of Article XXIV relating to customs unions, free trade areas or interim agreements leading to the formation of a customs union or free trade area. While dispute settlement can be used to challenge FTAs, to date, no WTO member has directly objected to an FTA using WTO dispute settlement.

If an FTA objectively does not result in a GATT customs union or free trade area or GATS economic integration agreement, permission not to comply with WTO obligations could be obtained through a waiver. Waivers have time limits and extensions have to be justified. Waivers also have to be approved by at least 75% of WTO members, and sometimes by consensus.

*Lode Van Den Hende is a partner, and Jennifer Paterson is an associate, at Herbert Smith Freehills LLP.*