

**THE SOUTH ASIAN FREE TRADE
AGREEMENT (SAFTA): TOWARDS A
MULTILATERAL FRAMEWORK**

SHAHID IRFAN JAMIL



**PAPER PREPARED FOR THE 10TH SAARCLAW
CONFERENCE HELD AT KARACHI, PAKISTAN
FEBRUARY 20-22, 2004.**

Introduction:

The South Asian Free Trade Agreement (SAFTA)¹, signed by the member states of the South Asian Association for Regional Cooperation (SAARC) at Islamabad, Pakistan on the 6th of January 2004, presents the seven South Asian countries² with numerous opportunities for participating in the multilateral trade agenda. Coming at a time when diplomatic relations between the nations of South Asia show definitive signs of improvement (specifically the thaw in relations between the governments of the two major economies of India and Pakistan), the conclusion of SAFTA represents a positive indicator of enhanced and mutually beneficial regional cooperation for the countries and provides a framework for concrete opportunities for trade between the signatory countries.

SAFTA proposes to build on the SAARC Preferential Trade Agreement (SAPTA)³ signed in 1993 between the six countries by taking the scope and depth of concessions and envisaged reductions of tariff and non-tariff barriers to intra-regional trade to a greater level than previously afforded by the states in the region.

SAFTA seeks to change the emphasis of SAARC economic regional cooperation from a policy of sustenance⁴ to actively enhancing⁵ it. SAFTA's ambitions extend to increasing the scope of the South Asian regional trade dialogue to include issues of competition⁶; trade and transport⁷ facilitation through progressive harmonization of legislation⁸; banking procedures⁹; macroeconomic consultations¹⁰; communications¹¹; foreign exchange regulations¹²; and immigration (currently SAFTA is only concerned with the facilitation of business visas).¹³ SAFTA also introduces a specific Trade Liberalisation Programme¹⁴ that phases down tariffs and eliminates quantitative restrictions in consonance with the obligations imposed by the WTO¹⁵. Article 20 of SAFTA also provides for a detailed dispute settlement mechanism¹⁶ under the auspices of a Council of Experts analogous to the Dispute Settlement Body (DSB) of the WTO. SAFTA also

¹ The text of the treaty is available at: <http://www.saarc-sec.org/summit12/saftaagreement.htm> on 15th February, 2004.

² The seven nations signatories to SAFTA and SAARC include the nations of the People's Republic of Bangladesh, the Kingdom of Bhutan, the Republic of India, the Republic of Maldives, the Kingdom of Nepal, the Islamic Republic of Pakistan, and the Democratic Socialist Republic of Sri Lanka.

³ See Recitals 4 & 6, and Article 22 of SAFTA.

⁴ Article 2(1) SAPTA

⁵ Article 2 of SAFTA

⁶ id. Art 3(1) (b) & 8(j)

⁷ id. Art 8(g) & (k)

⁸ id. Art 3(2) (e) & 8(a)-(e)

⁹ id. Art 8(f). Article 8(j) specifically mentions venture capital as being an issue for liberalization.

¹⁰ id. Art 8(i)

¹¹ id. Art 8(k)

¹² id. Art 8(l)

¹³ id. Art 8(m)

¹⁴ id. Art 7

¹⁵ id. Art 7(5)

¹⁶ Compare with Article 20 of SAPTA

becomes the umbrella RTA for the region unlike SAPTA¹⁷ which specifically envisaged the conclusion of other Agreements between Contracting States on a Sectoral basis.

SAFTA comes during a period where regional trade agreements (RTA) world-wide are proliferating. In fact, the period following the launch of the Doha Development Agenda in November 2001 has been one of the most prolific in terms of notifications to the WTO of RTAs under Article XXIV of the GATT 1947: during this two year period a total of 33 RTAs have been notified, of which 21 cover trade in goods, and 12 cover trade in services. In 2003 alone, 12 RTAs have been signed, negotiations have started on 9 new RTAs, and 13 have been proposed worldwide.¹⁸ The reasons for the proliferation involve a variety of economic and political factors including the fact that more and more regions in the world feel the need to pool their resources in an increasingly globalised world.¹⁹ Large economic groups like the EU are looking to extend cross-continental/regional ties, whereas, predominantly in the Asian region (eg. ASEAN etc), other countries are looking towards cementing relationships with their natural trading partners.

The aim of this paper is to highlight issues dealing generally with the use of SAFTA as a framework towards building an understanding of the workings of the multilateral trading system that will be beneficial for the members of SAFTA. In this regard, the overall philosophy of SAFTA (as well as the way SAFTA adds to SAPTA) can be considered to specifically illustrate issues for the multilateral trading system from which the developing countries of SAARC can gain a degree of exposure which can lead to their more proactive participation in the WTO. This paper will posit that the original conception of RTAs as a building block towards free trade²⁰ as envisaged by the drafters of Article XXIV of the GATT in 1947 holds true for SAFTA and SAFTA ought to be viewed as an opportunity towards enhancing participation in the WTO and multilateral cooperation rather than necessarily perpetuating a parochial protectionist sentiment.

The philosophy of RTAs- lessons from Brazil:

The extraordinary and unprecedented level of activity post-Cancun regarding negotiations and explorations of future RTAs²¹, reflects the fact that confidence in aspects of the multilateral system has suffered a setback after the stalemate between the Brazil and India led G-20 group of developing countries and the rest of the ‘developed’ world. Certain advocates of SAFTA within the South Asian region view SAFTA as falling within the larger construct of building South-South cooperation predicated on the political vision of the Non-Aligned Movement of the 1970s.²² This view of building a Southern block of developing countries is given further impetus by the fact that one of

¹⁷ SAFTA Art 1(6)

¹⁸ Clem Boonekamp “The Changing Landscape of RTAs”, Regional Trade Agreements Section Trade Policies Review Division of the WTO Secretariat, 2002.

¹⁹ SAFTA recognizes this proliferation in Recital 5

²⁰ Lloyd & MacLaren *supra* note 20 pg 1.

²¹ P.J. Lloyd & Donald MacLaren, “The Case for Free Trade and the Role of RTAs” University of Melbourne, 2002 at pg 23.

²² The Economist, “Looking south, north, or both?” February 7th, 2004 pg. 37.

the world's largest markets, the EU, has the highest concentration of RTAs in the world numbering over a 100 RTAs within the European continent.²³ The Brazilian President, Mr. Luiz Inacio Lula da Silva (a former trade union organizer) is one of the more vocal proponents of South-South cooperation and has been instrumental in the formation of the G-20 block.²⁴ The political vision underlying Brazil's endeavors stem from the ultimate aim of achieving a permanent seat at the UN Security Council- an issue on which both India and South Africa, two of the major players in the G-20, have a convergence of interest with Brazil.²⁵

At the same time, Brazil has also increased its multilateral participation by recently entering into a Mercosur RTA between the countries of that region and is seeking to increase its participation by entering a mega block of the Free Trade Agreement of the Americas (FTAA) as well as an EU-Mercosur Trade Agreement. Thus by becoming a 'hub' country capable of enjoying the benefits of various trade agreements, Brazil is seeking to expand its exports with North-South trade while also pursuing a policy of South-South Trade. This reflects an understanding of priorities that are instructive for all developing countries: Brazil is aware that although China has fast become Brazil's third-biggest trading partner, Brazil's major export market is still the US, EU and Mercosur nations. Brazil's exports to India only amount to USD 550m²⁶ thus emphasizing the fact that, despite its political aspirations, Brazil will still need to remain committed to the globalised multilateral trade agenda due to economic expediency.

The Structure of SAFTA:

Rules of Origin:

The text of the Agreement of SAFTA is sparse on the details of implementing the policies which it propounds. The Agreement reflects more of a policy document that apes the WTO's structure in terms of the issues adopted and, apart from the cursory Trade Liberalisation Programme is sparse on practical provisions and details requisite for a harmonious RTA.

Specifically, the most important aspect of an RTA which can be a powerful trade policy instrument are the Rules of Origin (RoO), (both preferential and non-preferential) negotiated under an RTA. The negotiation of a Rules of Origin Agreement will be determinative of SAFTA being either a trade creating or a trade diverting RTA.

Under Article XXIV, the WTO specifically provides for the creation of RTAs which can seek to achieve unilateral trade liberalisation within a certain region. To oversee this process, the WTO has also set up a standing Committee on Regional Trade Agreements (CRTA) that oversees the compliance of RTAs notified to the WTO under Article XXIV

²³ Boonekamp pg. 1

²⁴ The Economist, *supra*, note 22.

²⁵ *id.*

²⁶ The Economist, *supra* note 22

with the provisions of the WTO. In this regard one of the major compliance issues of an RTA are embodied in Article XXIV:4 which states:

“4. The contracting parties recognize the desirability of increasing freedom of trade by the development, through voluntary agreements, of closer integration between the economies of the countries parties to such agreements. They also recognize that the purpose of a customs union or of a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories.”(Emphasis added)

One of the responsibilities of the CRTA and the signatories to SAFTA will be a careful study of the RoO established under SAFTA to ensure that they do not end up raising barriers to trade of third parties to SAFTA.²⁷ The aim of the CRTA is to adopt a rules-based approach to balancing the requirement of an RTA to derogate from the provisions of the WTO with the need to ensure the smooth functioning of the WTO trading systems. In this regard, the CRTA will be employing the decisions on interpretations laid down by the DSB and the Appellate Body (AB)²⁸ to balance its quasi executive/administrative findings. The position is still unclear whether the CRTA would be open to a process akin to judicial review by the DSB.²⁹

The importance of RoO in multilateral agreements is underscored by the fact that the CRTA has raised the preferential RoO to a systemic issue in the negotiation agenda. Meanwhile, the WTO Committee on Rules of Origin is making strides towards finalizing the process of harmonizing non-preferential RoO at the global level.³⁰ This reflects the trade distorting effects that RoO may potentially have on an RTA. Specifically, the most important consideration to be guarded against is that RoO should not lead to trade diversion in the shape of the substitution of a more costly source of supply within the area for a less costly source outside the area.³¹ The aim instead should be trade creation defined as “the substitution of a lower cost source of supply within the area for a more costly source in the importing country”.³²

At the Seminar on Regional Trade Agreements & the WTO held on 14th November 2003, Estevadeordal & Suominen, of the Integrated, Trade and Hemispheric Issues Division, Integration and Regional Programs Department Inter-American Development Bank

²⁷ In the Turkey-Textiles case, the Appellate Body of the WTO has held that Article XXIV does not merely constitute an exception to the Most Favoured Nation (MFN) provisions of the WTO, but in fact the AB has interpreted Article XXIV as potentially constituting a departure from other provisions of the WTO. At the same time, to restrict a *carte blanche* interpretation and to restrict RTAs from going too far, the AB establishes the burden of proof on the RTA to assert an affirmative defense to a derogation from the GATT principles. In this regard, the AB lays down a two-pronged test for such an affirmative defense that states :

- a) that the arrangement overall meets the conditions of paragraphs 5 and 8 of Article XXIV; and
- b) that the infringement between members is necessary in order to complete the arrangement

²⁸ James H. Mathis, Ch.11 “Systemic issues in the CRTA” Regional Trade Agreements in the GATT/WTO, Asser Press, 2002 at para 11.2.

²⁹ *id.*

³⁰ Estevadeordal & Suominen, pg 1.

³¹ Lloyd & MacLaren *supra* note 21, pg 1

³² *id.*

Washington, DC in their paper “Rules of Origin in the World Trading System” have made three basic contentions on RoOs:

“First, the design of rules of origin regimes has important implications to trade flows: the more restrictive the RoO, the larger the trade diversion and other negative economic effects they create. Second, despite an ostensive de facto global convergence toward a few ostensibly similar preferential RoO regime models, even slight existing inter-regime differences can have important implications to firms’ outsourcing and investment decisions the world over, and potentially lead to the rise of exclusive trade- and investment-diverting hubs. Third, the Doha Trade Round presents a unique and most timely opportunity for attacking the distortions generated by restrictive and divergent RoO through multilateral means.”³³

Estevadeordal & Suominen also propose that the drafting of RoOs should be harmonized amongst the world’s RTAs in order to ensure that the least degree of distortions take place within intra-regional trade.

RTAs as a Laboratory -SAFTA :

The example of the EU quoted above can lead to the impression that the number of RTAs within a region are what matter. However, it is a recognized fact that the actual number of RTAs that a country enters into are not determinative of its economic importance, instead it is the sizes of the economies involved in that RTA that matter. *“For example, while the United States participates in only three of the some 180 FTAs notified to the WTO as of October 2003, the size and importance of the U.S. economy mean that these FTAs account for a significant share of world trade: in 2002, intra-NAFTA merchandise imports accounted for 9% of world imports, while intra-NAFTA merchandise exports accounted for 10% of world exports.”³⁴*

In this regard, it is instructive for the member states of SAFTA to follow Brazil’s policy of economic expediency and keep a focus on the multilateral agenda for trade. The spirit of regional cooperation provides a building block for SAARC developing countries to test and experience negotiations at the multilateral level. Ways in which these countries may find themselves able to gain a measure of rules-based multilateral experience can come from their participation in trade negotiations; both in negotiating concessions on tariff barriers as well as corollary RoO agreements, etc. Also, SAARC developing countries can use the CoE of SAFTA to gain exposure to the settlements of trade related disputes (especially in relation to safeguard³⁵ and balance of payments³⁶ measures that

³³ Estevadeordal & Suominen, *supra* note 30 pg 1. The authors move on to analyse the trade distorting/creating effects of different types of RoOs namely the Change in Tariff Classification (CTC), the exceptions attached to a CTC (ECTC), Value Content (VC) and Technical Requirements (TECH).

³⁴ Regional Trade Agreements Section Trade Policies Review Division WTO Secretariat Paper prepared for the Seminar on Regional Trade Agreements & the WTO held on 14th November 2003 pg 1.

³⁵ Art 16 of SAFTA

³⁶ Art 15 of SAFTA

may be required); thus building an institutional memory on dealing with trade related dispute settlement that can prove invaluable in contesting claims before the WTO's DSB.

Further, the unilateral liberalization that is envisaged in taking place in SAFTA can also lead to teething issues in participating in the WTO being mitigated and easier to handle. This is reflective in the fact that trade liberalization under SAFTA requires legislation to be harmonized to allow investment and trade and transport facilitation; part of the major so-called Singapore issues of the WTO. In this manner, a RTA generally, and SAFTA specifically, can potentially lead to a more phased in approach to reaching a *de minimus* standard from which the jump up to full WTO compliance can be facilitated. By recognizing the member states' obligations under the WTO³⁷, SAFTA seems to envisage this process and it is hoped that the negotiations that are to follow will be in line with the requirements of the WTO so as to allow SAFTA to be a controlled laboratory within which the member developing countries can test their abilities at multilateral trade negotiations.

In addition, with a successful experiment under SAFTA in relation to the trade in goods, further liberalizations³⁸ on other issues of importance such as Sanitary and Phytosanitary Measures, TRIMS, Intellectual Property Rights Measures, Services, etc can also be undertaken.

Conclusion:

The conclusion of SAFTA is an important first step towards forming a building-block towards greater multilateral integration in trade. The follow-up agreements on concessions, dispute settlement, Rules of Origin, etc have to be carefully monitored and should be seen as opportunities towards gaining experiences for the WTO's more complex rules. The philosophy of SAFTA should be to view it as a stepping stone towards greater integration into the world economy and the WTO as well as a laboratory for understanding the WTO's complexities. This is imperative for the developing countries in the region since a myopic focus on regional cooperation will only lead to the perpetuation of parochial protectionism within the region and defeat the purpose of the enthusiastic first step that SAFTA can represent. Such a view can only result in harming the countries involved with SAFTA through a self-imposed isolation from the international trading community.

³⁷ Art 3(2)(b) SAFTA

³⁸ Envisaged by Art 3(1)(d) of SAFTA