
1. The Working Party was set up by the CONTRACTING PARTIES at the beginning of the sixteenth session with the following terms of reference: "To examine, in the light of the relevant provisions of the General Agreement on Tariffs and Trade, the provisions of the Stockholm Convention and to report to the CONTRACTING PARTIES."

2. The Working Party had at its disposal the replies provided by the Member States to questions submitted by contracting parties in accordance with the procedures agreed upon at the fifteenth session for the examination of the Stockholm Convention, together with further information provided by Member States during a meeting of the Intersessional Committee on 9, 10 and 11 May 1960 and these were taken into consideration by the Working Party.

3. The Working Party first considered, in the light of the General Agreement, the relevant provisions of the Stockholm Convention and the problems likely to arise in their practical application. Secondly the Working Party considered, with particular reference to Article XXIV of the General Agreement, the provisions of the Agreement under which the Free-Trade Association arrangements should be considered by the CONTRACTING PARTIES.

I. THE PROVISIONS OF THE STOCKHOLM CONVENTION AND THEIR EFFECTS ON TRADE

A. Trade in Industrial Products

1. Area Tariff Treatment

4. The Member States said that the origin rules, which prescribed the criteria for identifying the goods to benefit from free-trade area treatment, were liberal in character and could not result in less favourable tariff treatment for goods imported from outside the area than such goods had enjoyed hitherto. From the trade point of view, these rules would enable many imported products to be used in the manufacture of goods which would pass duty-free into other Member States and this would benefit third countries.

1 L/1167 and Add.2.
2 L/1167/Add.1 and Add.3
Spec(60)142/Rev.1
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5. The Member States explained that a product from a third country which, before the establishment of the Association, had been liable to duty on entry into a Member State would continue to pay duty. If it were processed and exported from that Member State to another Member State it would not be liable to duty there if it satisfied the origin rules. If it were processed but did not satisfy the origin rules, duty would be payable when it entered another Member State; as the product did not qualify for area tariff treatment, however, it could continue to benefit from drawback if the exporting Member State so decided. In both cases, therefore, the position of third countries would not be less favourable from the tariff point of view. Moreover, from the trade point of view, the 50 per cent rule would enable many imported products to be used in the manufacture of goods which would pass duty-free into other Member States and this would benefit third countries.

6. It was argued in the Working Party that the position of products not qualifying for area tariff treatment might nevertheless be adversely affected through the loss of drawback under Article 7 of the Stockholm Convention. At present dutiable materials imported into the United Kingdom and used by a manufacturer for export trade were in most cases eligible for drawback. The fact that some of these materials could be obtained from territories enjoying tariff preferences had therefore not affected his choice as to the source of supply. With the withdrawal of the drawback privilege the United Kingdom manufacturer for the export trade would have a definite incentive to purchase his materials from sources enjoying preferential treatment. Thus while it might be true that the origin rules themselves would not result in less favourable tariff treatment for products imported by the Member States from third countries, the fact that products used in the production of goods qualifying for area tariff treatment would no longer benefit from drawback facilities would have an adverse effect on the trade of third countries. While no information on this point was available in respect of Portugal, it was likely that the same conditions would obtain there.

7. The Member States pointed out that under Article 7 of the Convention a Member State was permitted to refuse free-trade area treatment to goods which had benefited from drawback. If duties collected on raw materials were refunded when manufactures were exported and free-trade area treatment were given to those manufactures, there would be an artificial incentive for each Member State to manufacture for the others and to import from others the
manufactures it needed for its own use. This was not a problem peculiar to the Association, but must arise inevitably in any free-trade area or customs union. It was, however, important to keep the problem in perspective. First, there was no obligation on any country under the GATT to allow drawbacks and it was entirely within the discretion of any country granting drawbacks to withdraw them, whether or not this might be necessary through the creation of a free-trade area or customs union. Secondly, Member States imported a large range of raw materials free of duty and there could only be a very few materials which were dutiable in all the Member States; it followed that any tendency to direct trade to preferential sources of supply was liable to be offset by competition from Member States who could import the same materials free of duty from foreign sources and supply the manufactured goods free of duty throughout the area of the Association.

8. A question was asked as to whether the words "any goods" in paragraph 3 of Article 4 of the Convention could include imported goods not of area origin if imported from another Member State. If this were so, it would appear possible for a conflict to arise between the provisions of this paragraph and the requirements of the interpretative note to paragraph 9 of Article X of the GATT.

9. The Member States stated that, if a theoretical case of this sort did arise, the Member State concerned would, in accordance with Article 37 of the Convention, be bound by the interpretative note to paragraph 9 of Article X and the duty would be applied in accordance with that paragraph. The intention of paragraph 3 of Article 4 was to enable the Member States to follow more liberal policies; it was certainly not the intention of the paragraph to permit a product imported under a preferential tariff into a Member State to be re-exported without processing to another Member State.

10. It was also suggested that highly technical process criteria and the requirements of the origin rules could give rise to practical difficulties which could adversely affect the trade of third countries. Further, the possible need for manufacturers to keep two inventories, one for materials qualifying for area treatment and the other for materials which did not qualify, might induce them, for reasons of convenience, storage space and so on, to dispense with the second category of materials. This could affect purchases of materials from third countries, not only for the production of goods to be exported to other Member States but also of those to be exported to the outside world.
11. The Member States considered that this kind of difficulty was not likely to arise very often in practice. It would certainly not arise with regard to raw materials on the Basic Materials List, as these could be used regardless of origin. Admittedly border-line cases could arise, particularly in the chemical industry, where a manufacturer, in order to avoid any difficulty in showing that his product was going to qualify under the 50 per cent rule, would use a component from within the Area rather than from outside. The Member States have been aware of this difficulty, however, and the origin rules in the chemical sector have been drawn up so as to avoid as much as possible the problems which would arise for manufacturers if they had to segregate their raw materials according to their origin. In general, as a large number of products would easily qualify for area treatment under the processing criteria, the source of the materials would make no difference. Moreover, many raw materials were not available within the Area or were not available in sufficient quantities.

12. The Working Party then discussed the effects of the origin rules on the interests of those countries which were in the process of industrial development. It was pointed out that both the Basic Materials List in Schedule III and the list of qualifying processes in Schedules I and II meant that area treatment would be given to a product which had only undergone a small degree of processing within a Member State. Raw jute, for example, could be imported by a Member State, processed and exported to another Member State free of duty. If the country producing the raw jute processed it, the processed product would be liable to duty on importation into a Member State. The tendency would therefore be for the processing to be done within the free-trade area and for processing within the country producing the raw material to be discouraged. It was essential, particularly from the point of view of the less-developed countries, that the origin rules should not be operated in a way which only encouraged the export of raw materials from third countries and did not offer the same opportunities to their exports of finished goods.

13. The Member States explained that paragraph 2 of Article 4 of the Convention provided that materials contained in the Basic Materials List in Schedule III "which have been used in the state described in that List in a process of production within the Area of the Association shall be deemed to contain no element from outside the Area". This did not mean that all goods had to be
processed within the Area from the raw materials stage before qualifying for area treatment. Many of the processes in Schedules I and II started with semi-manufactures. Further, it was possible for a product to be used in a semi-manufactured state and to qualify for area treatment under the 50 per cent rule. The Member States agreed that the establishment of a free-trade area could have an impact on industries in certain third countries; this was unavoidable. Regional economic groupings were permitted by the GATT, however, and, in the case of the Association, every effort had been made to formulate rules of origin which were liberal in character and which would contribute to the Association's aim of facilitating an expansion of world trade.

14. The Working Party recognized that the rules of origin laid down by the Convention appeared, on balance, to be reasonable although the highly technical process criteria made it difficult to see clearly in advance what the effects on the trade of third countries would be. The question of the administration of the rules would be of great importance and, for this reason, the Member States' assurance that they had evolved the rules on as liberal a basis as possible and that it was their intention to administer and interpret them in the same spirit, was particularly welcomed.

2. Quantitative Import Restrictions

15. There was no agreement in the Working Party concerning the interpretation to be given to the rights of members of a free-trade area under Article XXIV in relation to the use of import restrictions.

16. The Member States held the view that, insofar as they maintained restrictions consistently with the GATT, Article XXIV would permit them to remove restrictions among themselves at a faster rate than against third countries and, although it was certainly their intention to follow liberal trade policies, they were not prepared to forego whatever rights they had under Article XXIV.

17. The other view put forward in the Working Party was that the provisions of Article XXIV did not affect in any way the obligations of contracting parties entering a free-trade area to apply quantitative restrictions in a non-discriminatory manner.

18. As regards the relaxation of balance-of-payments restrictions it was noted that such restrictions were justified only to the extent necessary to meet balance-of-payments difficulties and should be relaxed as the balance-of-payments
position of individual countries permitted. Articles XII and XIII in any case did not permit the discriminatory application of such restrictions except as provided for under Article XIV of the General Agreement. Furthermore, restrictions applied only to third countries would not be effective and, in any case, in the present circumstances of external convertibility of currencies, such discrimination would make even less sense.

19. The Member States recognized the force of the economic argument that had been put forward but there might be circumstances in which these arguments did not apply and in which the Member States would feel that Article XXIV would justify them in relaxing restrictions against imports from one another more rapidly than against imports from other sources. It was, however, certainly their hope to be able to relax restrictions on a non-discriminatory basis.

20. The Member States agreed that, if the balance-of-payments position of an individual Member State improved to the extent where it could remove quantitative restrictions more rapidly than was provided for in Article 10 of the Convention, it should speed up the removal of such restrictions in accordance with its obligations under Article XII of the GATT. There was nothing in Article 10 to prevent this; indeed, paragraph 2 of the Article referred to the elimination of quantitative restrictions "as soon as possible". The aim was that the reduction in customs duties between Member States should not be frustrated by the maintenance of quantitative restrictions and, in particular, that there should not remain a hard core of quantitative restrictions after customs duties between Member States had been eliminated. In this connexion paragraph 3 of Article 10 and the reference in that paragraph to the need to avoid burdensome problems in the years immediately preceding 1 January 1970 was relevant. The percentage increases provided for in paragraphs 5 and 7 of Article 10 were only minimum requirements and Member States were at liberty to relax their restrictions as quickly as their obligations under the GATT required.

21. As for the introduction of balance-of-payments restrictions by a Member State, it was agreed that such action should be taken only in the light of the balance-of-payments position of the Member State itself and that such restrictions should not be introduced by a Member State on the grounds that another Member State or Member States were experiencing balance-of-payments
difficulties. There was some difference of view as to whether Article XXIV of the GATT could be construed so as to allow a Member State to introduce restrictions on imports from non-members without extending them to imports from other Member States. It was the view of some members of the Working Party that balance-of-payments restrictions should be applied in accordance with the external financial situation of the Member State concerned. For example, in circumstances of external currency convertibility there would be no justification for imposing restrictions on imports from third countries while not restricting imports from Member States. The opinion of the Member States, on the other hand, was that this could only be determined in the circumstances of a particular case; that if a Member State could in the circumstances protect its balance-of-payments position by introducing restrictions against imports from non-members only, this would accord with the requirements of Article XXIV; but that, if restrictions had to be introduced against imports from other Member States also, the restrictions should conform with Articles XII to XV.