

GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED
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ASSOCIATION BETWEEN THE EUROPEAN ECONOMIC COMMUNITY AND THE REPUBLIC OF CYPRUS

Draft Report of the Working Party

1. At the meeting of the Council on 5 February 1973, the contracting parties were informed that on 19 December 1972 the European Communities had signed an Agreement of Association and a Complementary Protocol with the Republic of Cyprus (C/M/84). The following legal instruments were transmitted to the secretariat and subsequently circulated with document L/3870:

- the text of the Agreement establishing an Association between the European Economic Community and the Republic of Cyprus;
- the text of the Protocol laying down certain provisions relating to the Agreement establishing an Association between the European Economic Community and the Republic of Cyprus consequent on the Accession of new Member States to the European Economic Community; and
- the text of an exchange of letters, on Article 5 of Annex I to the Agreement establishing an Association between the European Economic Community and the Republic of Cyprus.

2. At the meeting of the Council on 30 July 1973, a working party was set up with the following terms of reference:

"To examine, in the light of the relevant provisions of the General Agreement, the provisions of the Agreement establishing an Association between the European Economic Community and the Republic of Cyprus, signed on 19 December 1972, and to report to the Council." (C/M/89)

3. The Working Party met on 22 February and on [date] 1974 under the chairmanship of Mr. L.J. Mariadason (Sri Lanka). It had available the text of the Agreement, the Protocol and the exchange of letters¹ referred to in paragraph 1 above, as well as the replies by the parties to questions asked by contracting parties (L/3988).
4. The representative of the European Communities presented the views of the parties to the Agreement, who considered it to be in full conformity with Article XXIV of the General Agreement both as regards the first stage, which was aimed at the progressive elimination of obstacles to trade, and as regards the second stage, which was aimed ultimately at the establishment of a customs union. In addition to a broad time-table provided in the Agreement, the Joint Declaration by the parties and the Preamble to the Agreement set out clearly their intention to establish a customs union. The historical, geographical and economic links between the parties had meant that, as in the earlier case of Malta, it was important for Cyprus to become associated with the process of European economic integration.
5. One member of the Working Party said that his authorities appreciated the efforts of the parties to the Agreement to maximize the trade coverage, but regretted that no plan and schedule had been submitted as required by Article XXIV:5(c) in the case of an interim agreement. He urged the parties to submit a detailed plan and schedule to the GATT as soon as possible.

¹For convenience these legal instruments are referred to collectively in this document as "the Agreement".

6. Several other members of the Working Party supported the view that the Agreement was in conformity with Article XXIV of the General Agreement. In addition, it was pointed out by some of these delegations that the Agreement would have a beneficial effect on the further economic development of Cyprus.

7. One member of the Working Party said that his government did not consider that the Agreement fully conformed with Article XXIV for three basic reasons. Firstly, no specific plan and schedule had been provided, as required by Article XXIV:5(c), and in the Agreement there was neither a binding commitment nor any assurance that a customs union would be established. Secondly, his authorities had serious doubts that a genuinely GATT-consistent customs union could in fact be established between countries having significantly different stages of economic development. Thirdly, the rules of origin under the Agreement were excessively restrictive and complicated, and seemed to his authorities to have been drawn up outside the context of the trade between Cyprus and the European Economic Community. The close similarity between the present Agreement and the one between the European Economic Community and Malta, which had been examined by an earlier working party, gave rise to the same type of objections which his delegation had raised in that earlier case.

Some other delegations supported the view that in the absence of a plan and schedule the arrangement could not be considered to be in conformity with Article XXIV.

8. The representative of the European Communities said that the parties considered that the specific obligations spelled out in the Agreement were tantamount to a plan and schedule. The 70 per cent reduction of import duties by the European Economic Community and the 35 per cent reduction of import duties

by Cyprus, set out respectively in Annexes I and II to the Agreement, were specific obligations during the first stage. The Agreement was also specific as to the parties' obligations during the second stage; and their intentions were clearly set out in the Joint Declaration. The parties viewed the time period as reasonable. In fact, it was shorter than that which had been provided in some other instances.

9. After the general discussion set out above, the Working Party proceeded to an examination of the Agreement based on the questions submitted and the replies provided on more specific matters. The main points made during the discussion are summarized below.

General questions

10. One member of the Working Party asked whether the term "provisional agreement" used in the text of the present Agreement was different from the term "interim agreement" as used in Article XXIV of the General Agreement. The representative of the European Communities answered that the parties had adopted language similar to that used in the past. The Agreement was not interim in the sense that it could be reversed, but rather it provided for stages towards a customs union and foresaw binding obligations of the parties. In addition, the Preamble and the Joint Declaration made it clear that the parties envisaged a complete elimination of tariffs on virtually all industrial imports into the European Economic Community at the beginning of the second stage, and a re-examination of the scope of the Agreement in other sectors, as well as the determination of procedures whereby Cyprus would progressively achieve a customs union. The member who had raised this point observed that the provisions of Article XXIV did not authorize "provisional agreements".

11. The same member of the Working Party enquired as to the specific experience in existing European Economic Community trade arrangements with countries at very different stages of economic development and industrial capacity which led the parties to expect that a customs union could be established in a reasonable length of time within the meaning of Article XXIV. He said that his question was related to the fact that the text of the Agreement referred to two stages but ... contained less than a total commitment. He asked whether the European Communities' past experiences, for instance in the case of their agreement with the developing countries which had entered into the Yaoundé arrangement, might be helpful in the examination of the present Agreement. The representative of the European Communities assured the other members of the Working Party that the parties to the Agreement did not have any apprehension about the success of the arrangement. Their concern was rather to satisfy the requirements of Article XXIV, and in their view they had done so.

12. The same member called attention to paragraph 3 of Article 2 of the Agreement, which dealt with "a further elimination" of trade obstacles during the second stage. His authorities would have had no objection, for example, to an elimination over nine years, but considered the language in that paragraph too imprecise. He noted that in another case of an association agreement between a developing country and the European Economic Community, the second stage extended to twenty-two years. The representative of the European Economic Community called attention to the French language version of the paragraph in question, which was "la poursuite de l'élimination" of trade obstacles. Moreover, as clearly stated in the Preamble to the Agreement, the parties had adopted the goal of progressively

eliminating obstacles to their trade. In their view there was no question of whether to eliminate, but only the question of how to do so, in the context of their firm commitment to establish a customs union. The member who had raised the question noted that Article 19 of the Agreement provided that the English language, as well as others, was equally authentic.

Rules of origin

13. One member of the Working Party enquired as to whether the rules of origin of the Agreement had in fact been discussed during the negotiation of the Agreement or whether they had been included because similar rules were included in a number of other trade arrangements. In the event that the rules had been discussed, he sought an explanation as to how the parties to the Agreement had arrived at such a complex and cumbersome system to govern the kind of trade that statistics indicated was flowing between the parties to the Agreement. It seemed to his delegation that the restrictiveness of the rules of origin might require an extensive change of sourcing away from third countries in order for products to be eligible for origin treatment.

14. The same member of the Working Party went on to say that an examination of the rules made him question seriously whether any of the processing steps in fact took place in Cyprus, or whether many of them could reasonably be foreseen within a reasonable period of time. For instance, in the event that Cyprus at some later stage would start a sewing machine assembly industry, why, he asked should that country be required to import the head of the machine and assemble it only from European Economic Community sources? Similarly, in the event of radio

transmitters being assembled in Cyprus why should not transistors be allowed from third countries? He enquired as to the possible economic criteria for these rules.

15. The representative of the European Communities considered that the negotiations leading up to the Agreement were not a subject to be enlarged upon in the Working Party. The position of the parties to the Agreement had been made clear in the reply to question No. 7, namely, that they did not consider that the present rules of origin, which in some respects were slightly different from those of similar agreements because attention had been paid to the trade exchanges between the parties, would have an inhibiting effect on the development of industry in Cyprus. The basic principles underlying the rules of origin had been explained on many earlier occasions; and any transformation or processing industry which existed or might be developed in Cyprus would not be impeded by them. Furthermore, the Agreement provided for the possibility of the parties' discussing the problems if practical difficulties were to arise. The parties had also made it clear that they would be prepared to examine the problem if these rules were to affect third parties' trade adversely.

16. With regard to specific cases given as examples in paragraph 14 above, the representative of the European Communities emphasized that there was no question of prohibiting the importation of any kind of component. Such components were merely not allowed to be imported in the framework of the Agreement in the first stage of reduced tariffs. The reason for this was to be found in the relationship between the value of the parts and the value added in the processing into a final product. Substantial or adequate transformation of the intermediate product was

required in order to benefit from origin treatment; and such was not the case in the examples given unless the requirements of the origin rules were met. Since the matter of the rules of origin in a number of free-trade agreements were subject to a request for bilateral consultations under Article XXII of the General Agreement he felt that it would be of limited use to carry much further the discussion of the present rules.

17. Another member of the Working Party, referring to the requirement of Article XXIV:5(a) that the general incidence of duties and other regulations of commerce imposed at the institution of a customs union, or interim agreement leading to the formation of a customs union, should not on the whole be higher or more restrictive than prior thereto, asked for assurance from the parties to the Agreement that the rules of origin would be administered so as not to increase the general incidence of trade barriers.

18. The parties to the Agreement said that in their view the Agreement fully satisfied the requirements of Article XXIV:5(a) in respect of duties and other regulations of commerce, in that the rules were not restrictive but simply defined originating products. The parties fully subscribed to the requirements of Article XXIV:5(a) and intended to abide by it.

Safeguard measures

19. One member of the Working Party asked whether the measures covered by Article 10 of the Agreement contemplated those which could be taken by either party with regard to the other, or whether this involved action that might be taken against third countries. The representative of the European Communities replied that the Article in question envisaged measures that might be taken by

one party or the other under certain circumstances. He said that any measures directed at third countries would only be taken in accordance with Article XIX of the General Agreement.

Trade coverage

20. In response to a question raised by one member of the Working Party, the representative of the European Communities said that Article 1 of Annex I of the Agreement dealt with what was to occur immediately at the entry into force of the arrangement, i.e., a reduction of the European Economic Community Common Customs Tariff by 70 per cent, whereas the Joint Declaration dealt with an exemption from customs duties and taxes having an equivalent effect at the beginning of the second stage. Annex II of the Treaty of Rome covered products considered to be agricultural. Pursuant to Article 1 of Annex I of the Agreement, these products were not subject to the tariff reduction or elimination obligations because in the agricultural sector the rôle of the tariff varied, depending upon the particular product involved. The parties had accordingly agreed to discuss the provisions to be applied to trade in agricultural products when making the arrangements for the second stage. During the first stage some specific agricultural products were nevertheless included, as set out in Annexes I and II to the Agreement.

21. The same member noted that the replies to questions 13(a) and 14(c) would indicate that agricultural products comprised 63 per cent of the European Economic Community imports from Cyprus and that 40 per cent of imports generally were excluded from the Agreement. In the view of his authorities this would indicate that the arrangement did not cover substantially all the trade between the parties, as required by Article XXIV:8(a)(i) of the General Agreement.

In reply, the representative of the European Communities agreed that 63 per cent of European Economic Community imports from Cyprus were agricultural products. A substantial part of this trade entered free of duty. As regards questions 14 and 15, these referred to trade that would be subject to reduction or elimination of duties in accordance with the obligations in the first stage of the Agreement. But it should be emphasized that the provisions under the Protocol for continued duty-free treatment for agricultural products entering the United Kingdom meant that [a larger amount] of European Economic Community imports would be exempt from duty during the first stage than was indicated in the replies to those questions.

22. Another member of the Working Party noted that in the reply to question No. 3 the parties referred to the elimination of customs duties and other restrictive commercial regulations on the "major part" of trade exchanges.

His authorities considered that the parties were required by Article XXIV:8(a)(i) to eliminate duties and other restrictive regulations of commerce with respect to substantially all the trade between them. The representative of the European Communities replied by calling attention to the French language text of that answer, "sont éliminés pour l'essentiel des échanges commerciaux", which was the exact wording used in the French language text of that passage in the General Agreement.

General considerations

23. Members of the Working Party expressed understanding for the historical, geographical and economic considerations that had led to the conclusion of the Agreement under examination.

24. Some members of the Working Party were of the opinion that the Agreement constituted a preferential trading arrangement that was not in conformity with Article XXIV of the General Agreement. Rather than a firm commitment to establish a customs union, there was only an undertaking to pursue a further elimination of trade obstacles; this did not constitute a plan and schedule, as required by Article XXIV:5(c). The trade coverage was clearly inadequate in the light of the requirement of Article XXIV:8(a)(i) that substantially all the trade between the parties be covered by the arrangement. Moreover, there was no assurance that additional agricultural products would be included. The rules of origin were unduly complex and restrictive with respect to third party suppliers, and appeared to have been drawn up without regard to the trade between the parties.

25. The parties to the Agreement, supported by several other members of the Working Party, held the view that the Agreement conformed fully to Article XXIV of the General Agreement. The trade coverage was high, and in the Joint Declaration the European Economic Community had declared its readiness to re-examine this aspect of the arrangement. In fact, the parties felt that at the end of the first stage it was more likely that the trade coverage would increase than decrease, and that this would apply both to the agricultural and industrial sectors. The rules of origin were neither restrictive nor unduly complex, and had been drawn up solely with the aim of identifying the origin of imported products.

26. The Working Party could not reach any unanimous conclusions as to the compatibility of the Agreement with the provisions of the General Agreement. Thus, it felt that it should limit itself to reporting the opinions expressed to the competent bodies of the CONTRACTING PARTIES.