

## FREEDOM OF TRANSIT: OBLIGATIONS AND IMPLICATIONS OF ARTICLE V OF THE GENERAL AGREEMENT ON TARIFFS AND TRADE

*Inadequate infrastructure and a weak regulatory, institutional and managerial environment, among other constraints, undermine the efficiency of transit systems in many developing countries, especially least developed and landlocked developing countries. In spite of what has been achieved to facilitate transit, greater national and international efforts and resources would be required to achieve the objective of freedom of transit as espoused under Article V of GATT.*

*As world trade continues to increase at a rapid rate, so does the need for efficient economic and environmentally sound national and international transport. With increased competition in major markets forcing business to adapt to just-in-time production and management systems, the commercial success of any export-oriented industry in developing countries depends more and more on its ability to satisfy customers in terms of speed, reliability and flexibility regarding the delivery of goods: **speed**, because the speed with which transport operations are carried out reduces the tying up of products – and therefore capital; **reliability**, because it reduces the risks of breakdown in the supply or distribution of goods, and therefore reduces the need for safety/buffer stock and **flexibility**, because transport logistics must be capable of adapting to variations in consumer demand and unforeseen circumstances.*

*This document briefly describes how WTO Contracting Parties have responded to the requirement of Article V of GATT. It highlights the notable achievements made in Europe with regard to **transit facilitation** and **freedom of transit** but also notes the fact that development of adequate infrastructure, including upgrading of existing assets, requires a degree of financing exceeding the means of many developing countries, notably the least developed and landlocked countries. It also points out that the decline in official development assistance and inadequate private financing has negatively affected many transit systems, and recommends that this trend be reversed. Furthermore, it recommends greater attention to project design to ensure that projects being implemented in developing countries, particularly in the least developed countries, are tailor-made and take into account those countries' low level of economic development.*

### A. Background

1. Article V of the General Agreement on Tariffs and Trade (GATT) provides for freedom of transit. It states, *inter alia*, that “There shall be freedom of transit through the territory of each Contracting Party, via the routes most convenient for international transit, for traffic in transit to or from the territory of other Contracting Parties”. It states further that “except in cases of failure to comply with applicable customs laws and regulations, such traffic coming from or going to the territory of Contracting Parties shall not be subject to any unnecessary delays or restrictions and shall be exempt from customs duties and from all

transit duties or other charges imposed in respect of transit, except charges for transportation or those commensurate with administrative expenses. It establishes most-favoured-nation treatment for such transit with respect to all charges, regulations and formalities.

2. The obligation arising from Article V of GATT to facilitate transit traffic, and more specifically, to ensure that such traffic is not subject to unnecessary delays or restrictions, commits Contracting Parties to providing transport infrastructure, i.e. “routes most convenient for international transit”, and also ensuring that customs and administrative regulations do not restrain transit traffic. In other words, Article V of GATT calls on the Contracting Parties on the one hand to provide adequate transport and related infrastructure for transit and on the other hand to provide a conducive regulatory environment in terms of streamlined customs and administrative regulations.

### **B. Regional or subregional approach to transit cooperation**

3. Although Article V of GATT commits the Contracting Parties to facilitating transit traffic individually, in practice, and since a large volume of goods in transit cross more than one national border, regional or subregional cooperation has become the main vehicle for achieving the aims set forth in Article V of GATT.

### **C. The European model**

4. The European countries, for example, acting under the auspices of the United Nations Commission for Europe, have adopted no fewer than 50 international conventions covering a broad range of transport and related issues, such as coordination of transport infrastructure, road traffic regulations, dimensions and weights of vehicles permitted to travel on certain roads, taxation of road vehicles, carriers’ liabilities, customs formalities, and special regulations relating to transport of dangerous goods.
5. Can the European model, in terms of development and maintenance of adequate infrastructures, reform of regulatory, institutional and managerial systems and commitment to international, regional and subregional cooperation, be replicated in developing countries? Not so easily. Transit facilitation in Europe is the fruit of many years of cooperation. The momentum for peace after the Second World War created tremendous political will, and in turn the rapid expansion of regional trade provided the incentive and justification for massive investment in national and coordinated regional systems of transport and communications.

### **D. The challenges of transit facilitation in developing countries**

6. Although efforts are being made to emulate the European model, the level of infrastructure development needed to facilitate transit and the reforms required to modernize and harmonize regulatory, institutional and managerial systems are generally beyond the financial and technical capacity of many developing countries, particularly the least developed and landlocked developing countries.
7. Current budget allocations to infrastructure development and maintenance in many developing countries, particularly the least developed and landlocked developing countries, are low and are likely to remain so because higher investment is difficult to justify, given

the low volume of regional trade and the need to finance other national economic and social sectors. Moreover, implementation of projects involving high standards and sophisticated systems originally designed for application in Europe poses immense difficulties owing to lack of adequate trained manpower.

8. To help developing countries, notably the least developed and landlocked developing countries, to implement their obligations arising from Article V of GATT, financial and technical assistance is needed.
9. Essentially, the call for technical support is not a new one. However, there is a need to improve the way in which technical assistance is delivered. The level of project failure in developing countries should be reduced.

### **1. Project design and project under funding**

10. Project failure can be attributed to many factors, with some of the main ones relating to project underfunding and project design.
11. Project underfunding is quite common. Projects have frequently been abandoned in midstream because commitments to fund subsequent phases were not honoured. A project to promote a legal framework for transit at a regional or subregional level, for example, to be successful, normally requires the completion of four distinct phases:
  - Negotiation and adoption of the legal instruments;
  - Legislative work to translate and internalize the legal instrument into national legislation;
  - Mobilization of financial and human resources in support of implementation of the intended reforms;
  - Management of change on a sustainable basis.
12. Typical project design failures relate to attempts to introduce complex transit facilitation schemes which end up as “white elephant” projects. Lessons from past experience show that any transit facilitation instrument or scheme, to be successfully implemented, requires the existence of a strong supportive environment, including the involvement and participation of both public and private stakeholders. This is especially true if the private sector is expected to play a major role in project implementation. Many donor-driven projects in the past did not involve the private sector during the design phase, even when the private sector was expected to play an important role in project implementation. Public–private sector consultation can improve project design and ensure effective implementation.
13. One example of a good system which works well in Europe but which it has not been possible to implement in West Africa since 1982 is a regional customs transit system based on the Customs Convention on the International Transport of Goods Under Cover of TIR Carnets (The TIR Convention). If public–private sector consultations had been carried out in West Africa in 1982 to implement a regional customs transit system, they would have shown clearly that implementation would not be feasible because of lack of key institutions, notably road transport associations at both the regional and national levels, and weak banking and insurance firms, which were not capable of providing the necessary financial guarantees. The institutional support system has not changed much over the years.

14. The Convention relating to Inter-State Road Transit of Goods adopted by States members of the Economic Community of West African States in 1982, but not implemented, like its TIR Convention counterpart, sought to establish standards which were too difficult for the poor West African countries to comply with. Both conventions seek to provide a customs transit system based on the principle that (a) goods must travel in secure vehicles or containers; (b) duties and taxes at risk throughout the journey are covered by an internationally valid guarantee; (c) the goods are accompanied by an internationally accepted carnet taken in use in the country of departure and accepted in the countries of transit and destination; and (d) customs control measures taken in the country of departure are accepted by transit and destination countries.
15. None of these four pillars of the TIR Convention could be established in West Africa. In the first place, 70 per cent of vehicles available for transit operations were ordinary open-top lorries which could not satisfy the technical requirements set out in the Annex to the Convention, under which load compartments of transit vehicles ought to be constructed in such a way that access to the interior is not possible once vehicles have been locked and secured by customs seal. Since most vehicles in West Africa are technically inappropriate for transit operations in West Africa, they are subject to very strict and cumbersome customs controls, including customs escorts.
16. Similarly, for a variety of reasons, the West African States have failed to introduce both the internationally valid guarantee system and the international customs declaration document, the “Carnet”, and as a consequence, the full range of customs control measures taken in the country of departure are repeated in each of the countries of transit, as well as in the country of destination. These procedures result in enormous delays and avoidable costs.
17. The failure to implement the TIR Convention in West Africa demonstrates that systems developed for application in industrialized countries may be inappropriate in the developing country context. However, such systems could become viable if adjusted appropriately. In this context, consultations with all the stakeholders, including the private sector, are vital.
18. Proper project design, public–private sector consultations, adequate project funding and management of change on a sustainable basis are thus critical factors in transit facilitation programmes. Such factors apply to both physical infrastructure and non-physical infrastructure projects.
19. As many developing countries, notably the least developed, face serious economic problems, including a lack of adequate infrastructure, financial and technical assistance continues to play a central role in promoting transit facilitation. In this connection, it is regrettable that external support, instead of strengthening, has been weakening.

## **2. Infrastructure development: lack of adequate investments**

20. In the 1990s, official development assistance (ODA) commitments to developing countries were \$59 billion.<sup>1</sup> Although these financial flow figures were significant, they represented a 50 per cent drop compared with the previous decade. In a few large developing countries

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<sup>1</sup> J.I. Stone, *Infrastructure Development in Landlocked and Transit Developing Countries: Foreign Aid, Private Investment and the Transport Cost Burden of Landlocked Developing Countries*, UNCTAD/LDC/112.

during the 1990s<sup>2</sup>, and particularly as regards the telecommunication and energy sectors, private capital flows more than compensated for the loss of ODA, but for the majority of landlocked and transit developing countries the decline in ODA was not offset by private capital flows. Consequently, there is still a substantial deficit for these countries particularly when projected population growth and accelerating urbanization are taken into account. In these countries, a substantial increase in investment is required just to maintain the status quo. The World Bank has estimated that Africa alone needs \$18 billion to be invested in infrastructure on an annual basis. There is therefore a need to reverse the decline in external finance, especially ODA.<sup>3</sup>

### **3. Aid pattern and orientation**

21. In addition to the decline in aid, the current aid pattern has been oriented towards improving national infrastructure rather than promoting regional or subregional transport networks. This aid pattern leads to serious inefficiencies. Those countries that are lucky enough to receive aid maintain their infrastructure, while those that do not fail to do so, with the consequence that most transit systems remain inefficient because there are always some bottlenecks somewhere along the line. It is important to remember that the strength of a chain, as the maxim says, is determined by its weakest link.

### **4. Increased external financing to promote transit facilitation**

22. While developing countries have made some progress in enhancing their transit transport cooperation, and the international community has contributed significantly to this achievement, much remains to be done. Additional investment, notably to construct missing links, and maintenance funds to meet recurrent costs are urgently needed. Technical assistance is also required in order to consolidate earlier gains related to the harmonization, simplification and standardization of transit procedures and documentation. Ongoing regulatory, institutional and managerial reforms must be sustained, and public-private sector dialogue and consultations need to be strengthened.
23. If adequate external support can be ensured, the chances of success for project implementation will benefit from emerging forces, notably (a) the expanding role of the private sector as a service provider; (b) the opportunities which new technologies now offer in increasing both business efficiency and official control functions; (c) better-trained manpower in both the public and private sectors; and (d) greater public/private dialogue and cooperation.
24. UNCTAD estimates that a comprehensive transit facilitation programme package for each least developed country could cost around \$3 to \$5 million. For the 49 LDCs, the total technical assistance requirement would then be in the order of \$240 million. In addition, significantly greater resources are required for the construction, maintenance and improvement of their transport, storage and other transit-related facilities, including alternative routes and improved communications.

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<sup>2</sup> Brazil, Argentina, Mexico, Republic of Korea and Malaysia.

<sup>3</sup> "Transit Systems of Landlocked and Transit Developing Countries: Recent Developments and Proposals for the Future", TD/B/LDC/AC.1/17.

## **E. The role of UNCTAD**

25. UNCTAD has played a pioneering role in the development of the international transport policies of developing countries through its work in the fields of trade facilitation, land-locked developing countries, multimodal transport, trade efficiency and transport information systems. Priority areas of work which have achieved some success include:
- Assistance in negotiating and/or implementing bilateral and regional agreements and arrangements;
  - Streamlining and harmonization of documentation and customs procedures;
  - Assistance in implementing policies and procedures to reduce transit costs;
  - Assistance in institution building and human resource development in the transit sector;
  - Reducing the administration costs of external trade control activities;
  - Helping Governments to secure a more effective application of external trade regulations, leading in most cases to an increase in revenue;
  - Accelerating the clearance of goods while maintaining effective control of the flow of goods; producing timely and reliable data as a basis for external trade statistics and management reports;
  - Better use of transport equipment (for example, locating equipment, quicker turnaround times enabling wagon fleets to generate higher revenue if traffic increases, and simplified maintenance monitoring);
  - Reduction in transit times of goods (through the facilitation of traffic flows at border crossings and interchange of rolling stock between networks) and simplified wagon hire compensation formalities;
  - Improved quality of transport services offered to the customer (shipper, forwarder) and of data on cargo whereabouts, thereby facilitating takeoff and delivery, and reduction of insurance costs.
26. UNCTAD therefore has an important role to play in the future, but it needs resources from bilateral donors and financial and development institutions.