

**DISCUSSION PAPER ON THE INCLUSION OF THE GOODS MOVED VIA FIXED  
INFRASTRUCTURE INTO THE DEFINITION OF TRAFFIC IN TRANSIT**

Communication from Egypt and Turkey

The following communication, dated 1 June 2012, is being circulated at the request of the delegations of Egypt and Turkey for consideration by the Negotiating Group on Trade Facilitation.

**I. INTRODUCTION**

This communication has been presented in order to better explain the concerns of the proponents regarding Paragraph 1 of the Article 11 of the Draft Consolidated Negotiating Text (TN/TF/W/165/Rev.11) on Freedom of Transit.

**II. BACKGROUND**

The concept of "goods moved via fixed infrastructure" first appeared in the Trade Facilitation Agenda in Communication G/C/W/422 dated 30 September 2002 by the European Union even before the start of negotiations. In that document, the proponent of the document submitted that "carriage e.g. of oil and gas and other products via pipelines or other means may also fall within the scope of transit".

The concept first took place in the agenda of the negotiations through the Communication TN/TF/W/79 dated 15 February 2006 by Armenia, Canada, the European Union, the Kyrgyz Republic, Mongolia, New Zealand, Paraguay and Republic of Moldova. In that document, under the title "Operationalization and clarification of terms", the definition of traffic in transit in GATT Article V:1 was reviewed and the following expression was inserted into the definition: "Goods (including those moved via fixed infrastructure, inter alia pipelines, baggage and the personal belongings of the person operating the means of transport)". The same expression existed in the proposal TN/TF/W/113 dated 6 June 2006 by Armenia, the European Union, the Kyrgyz Republic, Macedonia, Mongolia and Republic of Moldova.

The expression has been preserved in the joint proposal TN/TF/W/133 dated 10 July 2006 by Armenia, the European Union, Macedonia, Kyrgyz Republic, Mongolia, Paraguay, Moldova, Rwanda and Switzerland, however the initial proponent of the expression has not been a sponsor to its three revisions. The proposal took its current shape as it appears in Paragraph 1 of the Article 11 of the Draft Consolidated Text during the facilitator led process by Switzerland, Turkey and Rwanda and later on by Mexico.

During the negotiations up to date, the proponent of the provision regarding the fixed infrastructure submitted that the explicit inclusion of the goods moved via fixed infrastructure into the

definition of traffic in transit was a mere clarification of the scope of GATT Article V which already covers energy products including those moved via fixed infrastructure. On the other hand, a number of delegations expressed their concerns on the applicability of the text on freedom of transit to the energy sector and the potential inconsistencies if such an application would occur. One delegation submitted a counterproposal to clarify some of the points that may be relevant for the energy sector. The proponent also argued that fixed infrastructure such as pipelines were represented a mode of transportation like other modes. Some delegations questioned the assumption that energy products, particularly those moved via fixed infrastructure are actually covered by GATT. Those delegations submitted that the concept repeated throughout the Article V was "traffic in transit" and this concept inherently leaves out transportation via fixed infrastructure. In this sense, those delegations argued, inclusion of goods moved via fixed infrastructure would mean a change in the scope of original GATT Article V.

### **III. THE ISSUE**

#### **1. Are Energy Products subject to GATT?**

The proponents of the present communication do not question the applicability of GATT provisions to energy products. No products are *ex ante* excluded from the scope of GATT disciplines. As there is no provision explicitly leaving the energy products out of the scope of GATT, in principle, the trade of energy products such as petroleum and natural gas<sup>1</sup> between WTO Members is subject to GATT provisions. In fact this has been confirmed by a number of Panel and Appellate Body rulings both during the GATT and WTO times.<sup>2</sup>

However, the problem does not lie with the fact that energy products are subject to GATT. Rather, the problem is related to the fact that GATT provisions were not designed to deal with the energy sector, particularly with the transit via pipelines.

#### **2. Why Energy Sector is Different than Other Sectors?**

Trade in energy products, like some other natural resources, has a totally different nature than the trade in conventional products. This is due to the fact energy products are scarce in nature and face a highly inelastic demand. Hence, while in conventional products, the trade distorting measures concentrate on the importation side (tariffs, non-tariff measures, discriminatory practices etc.), in energy trade, such measures concentrate on the exportation side. The exporting side has an incentive to restrict the supply and exports of the product while the importing side has an incentive to lower the barriers at the importation side and to ensure the security of supply.

GATT rules and disciplines are not drafted to deal with the specific cases arising from the above mentioned market structure. Instead, the text of GATT 1947 has been drafted mostly to address the potential cases of protectionism at the importation side. The fact that there are no disciplines in GATT regarding the most commonly faced restrictive practices in the energy trade such as dual pricing or export taxes or restrictions is a proof of that situation.

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<sup>1</sup> While petroleum or natural gas are products within the scope of GATT, it is questionable whether electricity is a good which is subject to GATT. Unlike oil and gas it is not a physical substance that can be stored easily. Electricity is a physical process (a flow of electrons) which takes place throughout the cables that carry it and it has to be generated more or less at the same time as it is being used. The fact that there is an HS Code for electricity –namely 27.16.00- , taking into account the decision making process in the WCO does not ensure that electricity has been unambiguously accepted as a good within the WTO context.

<sup>2</sup> GATT Panel on *United States – Taxes on Petroleum and Certain Imported Substances*, Report of the Panel adopted on 17 June 1987 (L/6175-34S/136), more recently the Appellate Body Report on *United States – Standards for Reformulated and Conventional Gasoline* adopted on 19 April 1996, WT/DS2/AB/R

### **3. The Negotiating History of GATT proves that GATT is not designed to deal with Energy Matters**

A closer look at the negotiating history of GATT would clearly reveal that it has not been drafted having the energy trade in the mind of the negotiators. Apparently, pre-dominantly for political reasons, energy-related issues have not been included in the GATT negotiations. A closer examination of the negotiation history of both GATT in general and GATT Article V in particular reveals that energy trade and in particular trade via pipelines has not been an issue discussed during the preparatory committee works.

For the case of pipelines, the term used throughout GATT Article V, -traffic in transit- is another indication that the drafters did not have transit through fixed infrastructure in their mind as this term would normally be used for moving vehicles.<sup>3</sup>

This was, however, not because energy related issues –even the case of pipelines- were uncommon or unknown in international community. The origins of the use of pipelines as a transportation method for oil and gas goes back even to 19<sup>th</sup> century and in 1930s, there was already a network of existing and planned projects of border crossing pipelines in the Middle East region. Indeed, there were international conventions specifically dealing with the issue of energy transit via pipelines<sup>4</sup> or energy grids<sup>5</sup> concluded before the starting of negotiations on GATT.

As a necessity of a common binding regulation on energy related issues, the Energy Charter Treaty has entered into force in April 1998 and to date, the Treaty has been signed or acceded to by 53 states or entities. The trade related provisions of the Energy Charter Treaty, that many of the members are also members of WTO, are based on the WTO rules.

### **4. The Peculiarities of the Transit via Fixed Infrastructure**

Having established that GATT Article V disciplines are not designed to govern the transit of energy products via fixed infrastructure, it is warranted to show that transit via fixed infrastructure has peculiar characteristics which do not exist in the conventional modes of transportation.

At the essence of these characteristics lie the economic properties of fixed infrastructure used for transit. Fixed infrastructure such as petroleum or natural gas pipelines, especially border crossing pipelines, require massive investment before its operation. Thus, the fixed costs of the operation are very high whereas the variable costs constitute only a smaller portion of the total costs.

Consequently, pipelines, especially border crossing pipelines are, for most cases, project specifically built. They are not built, like roads to open to international transit, for general purposes of transportation. Such pipelines are built, however, to transport a certain type and quality of petroleum or natural gas from one specific destination to another one. As the pipeline projects mostly require high levels of investment, a project would not be carried out without guaranteeing the amount of gas or petroleum to be transported by it.

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<sup>3</sup> See for instance The Concise Oxford Dictionary of Current English.

<sup>4</sup> "The Convention on Pipeline Construction" (Convenio sobre Construcción de Oleoductos) signed at Regional Conference of the River Plate Countries on 6 February 1941. This Convention is indeed a treaty having highly advanced provisions on the construction and operation of pipelines through each other's territory which includes transit. The Contracting Parties also undertake national treatment regarding the operation of those pipelines.

<sup>5</sup> "Convention Relating to the Transmission in Transit of Electric Power" signed under the auspices of League of Nations on 9 December 1923. Although this convention was signed at a quite early date, it has detailed provisions on the transmission in transit of the electric power through power grids.

Energy trade via pipelines is a chain consisting of the producer, the transporter and the consumer as the actors of the business. Energy trade should not be confined to one single actor. Hence, the investments in production and transportation sides are strictly bound to the consumer side. Since the investment in production is much higher than the investment in the other sides, without the purchase commitment of the consumer, there will be no investment in the upstream, midstream and downstream. This principal is core to the materialization of the energy trade via pipelines.

As a result, it is unusual for pipelines to operate with a considerable spare capacity which would indicate an economic inefficiency. Given the lack of such spare capacity and given that nowhere in GATT Article V Members are obliged to expand their transit capacity or to allow the construction of new transit infrastructure, it is practically impossible to fulfil the requirement in Article V:2 –to provide freedom of transit via the most convenient route- which would mean access by third parties to the operating pipeline.

One particular consequence of the "investment-dependence" of pipelines is that provisions regulating the trade via pipelines should be paired with the provisions regulating the investment for such infrastructure as this is case in bilateral or multilateral agreements regulating trade via pipelines. Unless such provisions exist, it is likely that significant incompatibilities arise between the rights and obligations of the investors and the traders. Since WTO is not a platform to deal with investment issues, bringing up these matters in Trade Facilitation Negotiations does not seem feasible.

Another practical issue regarding fixed infrastructure is that projects to build and operate pipelines often involve private sector partnership. In some cases, a private sector dominated consortium established under private law owns the pipeline and is responsible for its operation. Naturally, WTO Agreements create obligations for Members but not for private entities. While there can be extreme cases where Members are obliged to take necessary measures vis-à-vis the private entities to ensure freedom of transit through its territory<sup>6</sup>, obviously, a privately owned border crossing pipeline through the territory of a Member would not fall under this category. Taking into account that such a pipeline would be built to transport a certain type of natural resource from one point to another for commercial reasons, this situation resembles more to a case where a private company builds a private railway line to transport coal from the mining site to a port. In such a case, a third party aspiring to transport coal on the same route would either have to build its own infrastructure or seek for access to the existing infrastructure on commercial terms.

One more important question regarding fixed infrastructure is on whether the fixed infrastructure should be regarded as "a means of transport" or not. Previously, some delegations submitted that fixed infrastructure is a type of transportation infrastructure just the like highways in the road transportation case and thus should be regarded as out of the scope of "traffic in transit" mentioned in GATT Article V. In this case, a natural resource flowing through the pipeline would resemble the goods moving on a road. While this argument has some merit and pipelines exhibit some properties of a transportation infrastructure, it also true that pipelines exhibit the properties of a means

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<sup>6</sup> One such extreme case would be where all highways available for international transit through the territory of a Member are privately owned. In that case, that Member would be under an obligation to take necessary measures to provide transit passage for other Members since any other action would mean a total denial of the right to transit by other Members. One should, however, be very cautious when comparing this case and the case of privately owned pipelines. When there is, for instance, a road that is open to public use and which is privately owned or operated, there is a concession agreement between the state and the operator so that the state transfers its public service duty to a private entity while the ultimate responsibility to carry out the public service lies with the state. In exchange, the private entity undertakes to carry out the service in accordance with principles according to which the public services should be conducted such as impartiality, non-discrimination and transparency. As one can easily judge, this case is not comparable to the case of privately owned pipelines, since the transfer of oil and gas through pipelines has no public service aspect.

of transport. As a result, a pipeline is built exclusively to transport a certain type of natural resource and the physical characteristics of the pipeline highly depend on the physical characteristics of the natural resource to be transported. For example, the ratio of sulphur content, viscosity, etc... of the product simply affect the selection of the type of the steel and pumps and many other technical parameters of the pipeline design. That is to say, a product incompatible with the technical specifications of the pipeline cannot be transported as this would result in irrevocable damages to the whole system. In this sense, the difference between the transportation infrastructure and the means of transport blurs and a pipeline can easily be regarded as a special means of transport built to carry a specific good from definite destination to another.

The consequences of this duality are significant. If pipelines are regarded as transportation infrastructure, the above-mentioned concerns will continue to exist. On the other hand, if pipelines are regarded as a means of transport, then further complexities will arise. In that case, fixed infrastructure itself will become a part of the traffic in transit and as there is freedom of transit for traffic in transit, the question on the construction of new pipelines through the territory of a Member will arise as an important issue. If pipelines are a means of transport and they are privately owned, the above argument on the third party access to the privately owned pipelines would find an even stronger application. There is even less doubt that WTO provisions would not apply to the operation of a privately owned means of transport.

Another example of disharmony is related to the lack of a basic principle concerning transit via pipelines in GATT Article V or the draft text on freedom of transit. "Non-interruption in the case of a dispute" is an essential principle existing in most legal texts regulating the transit via pipelines including the Article 7 of the Energy Charter Treaty. Without this principle, which does not appear in GATT Article V, invoking the dispute settlement mechanism of the WTO regarding a dispute regarding the transit via fixed infrastructure would almost become meaningless.

These issues, among others, are examples of the significant incompatibilities and uncertainties between the current Article V and Article 11 of the draft text with the pipeline based energy sector. It is only normal that such incompatibilities or uncertainties exist since, as we have mentioned, these texts were not drafted taking into account the aspects related with pipelines. In fact, one can confirm this position by comparing the text of GATT Article V and a legal text which was specifically drafted to handle energy transit via fixed infrastructure and which was drafted based on GATT Article V such as the transit article of the Energy Charter Treaty (ECT).

Some commentators argued that such incompatibilities or uncertainties can be resolved through interpretation of the current texts and there were attempts in that direction. However, considering energy is a strategic and vital one for many of the Members, the proponents are of the view that such cases cannot be resolved through mere interpretation.

#### **IV. THE WAY FORWARD**

In this context, the proponents of the current communication are of the view that the explicit inclusion of the element of fixed infrastructure in the definition of traffic in transit in Paragraph 1 of the Article 11 cannot be perceived as a "simple clarification" as this action would have much more significant consequences than a simple clarification. As we have emphasized, the concerns do not stem from the applicability of GATT to energy products or from a motivation to open up a discussion on this applicability. Rather, these legitimate concerns are related to the potential inconsistencies with the current texts which are not designed for transit of energy products via fixed infrastructure.

Under these circumstances, the proponents believe that the current formulation on fixed infrastructure does not serve even the purpose of the advocating Member itself. Hence, regarding the way forward on this issue we need to consider different options.

One option may be leaving aside the issue of fixed infrastructure for the current negotiations by dropping the Paragraph 1 from the text. This would indicate that Members recognize that current GATT Article V is not a fully adequate means deal with specific energy cases while not opening up a discussion whether energy products are subject to GATT or not. This would also indicate the willingness of Members to continue to deal with energy specific issues on energy specific platforms such as the ECT while not closing the door for prospective negotiations on energy related provisions.

Another option might be to address each and every potential issue related to fixed infrastructure by making additions or amendments to the current text on freedom of transit. However, trying to deal with both conventional means of transit and transit via fixed infrastructure in the same text would either necessitate an aggregation of the provisions or creating exceptions for fixed infrastructure. In both cases, the current text which was mainly drafted having conventional means of transportation in mind would be distorted. Moreover, the negotiations on freedom of transit would be much more complicated as different interests would have entered into the picture.

Finally, a third option may be to deal with the transit via fixed infrastructure with a separate provision. Taking into account the peculiarities mentioned above, this provision may tailor the basic principles existing in GATT Article V and in the current draft text to the transit via fixed infrastructure. In doing this, Members may benefit from the already existing texts to specifically handle the questions regarding transit via pipelines such the Article 7 of the ECT or the draft Transit Protocol of the ECT. Nevertheless, this option may also create difficulties as not all Members are parties to the ECT and lack of any guidance on this separate provision may lead to similar type of difficulties existing in option 2.

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