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**Seeking Multilateralism Friendly FTAs:
The Research Agenda**

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APEC STUDY CENTER
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I. Introduction: Background and Aims of the Research Project

Since the 1990s, the number of bilateral or regional free trade agreements (FTAs) that have been signed, or are under feasibility study or negotiation, has increased dramatically.¹ In the Asia Pacific region, for instance, along with the countries like the United States, Canada, Mexico and Chile that have included FTAs as one of the options in pursuing their trade policy objectives by early 1990s, countries like Japan, Korea, China, Australia and New Zealand, which traditionally gave policy priority to multilateral liberalisation, have started to promote their own FTAs in recent years. In addition, some ASEAN countries, namely Singapore and Thailand, now see the formation of FTAs with extra-regional countries as an important and tangible policy option, though they used to prioritise the ASEAN Free Trade Area (AFTA) as their most important trade liberalisation framework. Considering these trends, there may emerge a complicated “web” of FTAs in the region by the end of this decade.

In economic theory, it has been argued that global free trade would maximise economic benefits and minimise costs both in individual countries and globally at the same time. If all countries are to maximise economic welfare by acting according to the theory, they would reduce their tariffs and other trade barriers unilaterally, if these existed in the first place, on a most favoured nation (MFN) basis. There would be no need for multilateral liberalisation processes or the formation of FTAs. However in reality, complete free trade has never been realised even at the level of an individual country, because policy decisions are made not only to pursue the pure economic welfare of the domestic economy as a whole, but also to achieve policy objectives according to domestic political and strategic preferences.

Under these circumstances, the General Agreement on Tariffs and Trade (GATT) system after the World War II has been working relatively well towards the purpose of achieving “freer” trade in “wider” area of the globe. At the same time, the GATT/WTO allowed, with some conditions, regional and bilateral trade arrangements, including FTAs, to be formed under its Article XXIV and others as an “exception” to its basic principles of multilateralism and non-discrimination.

¹ For the detailed number of Regional Trade Agreements (RTAs), including FTA, notified to the WTO by September 2001, see WTO (2001).

Though some problems of the GATT/WTO system surfaced in recent years,² its principles of multilateralism and non-discrimination are still working as strong guidelines for trade policy behaviour for its members. All countries that are moving towards FTAs argue that their FTAs are not to hinder the multilateral liberalisation process under the WTO. Moreover, they often claim that the FTA formation will play a role to promote, or complement, multilateral liberalisation process.³ However, the logic behind why the formation of FTAs and the eventual emergence of a web of FTAs should promote multilateral liberalisation remains ambiguous.

Multilateralists' argument against FTAs seem to be based on two points: first, by its nature, an FTA discriminates against countries outside it, and this simple fact is against the basic principles of the WTO; and, FTAs would complicate the tariffs and trade rules applying to the same products. For example, if country A signed FTAs (i.e. not customs unions) with countries B and C, and the A-B FTA and the A-C FTA applied different tariff rates on a same product, the exporters and importers in A would face three different tariffs on the product: the A-B FTA rate, the A-C FTA rate and the MFN rate that would be applied to all other countries. This alone would increase the transaction costs for the exporters and importers in the country A. Moreover, if the rules that usually accompany the tariff element in an FTA, such as the rules of origin, were set differently, or even contradictory, between the A-B FTA and the A-C FTA, it would complicate their international economic transactions even more. Bhagwati (1995) called this the "spaghetti bowl" effect.⁴ The situation would grow worse when a complicated "web" of FTAs emerged. Also, even if an FTA aimed for "deep" and "wide" integration (World Bank 2000: 79-90) covering new issues like services, anti-dumping, subsidies, investment and other trade facilitation measures including customs procedures and product standards that were not sufficiently covered by the WTO, the coverage, naturally, would be applied just to countries within the FTAs. Thus,

² The WTO Ministerial Conference in Seattle in 1999 could not launch a new round of trade negotiations. Two years later in 2001, the WTO members agreed to start the new round in Doha, Qatar, but differences in opinions remain regarding particular aspects of liberalisation, such as anti-dumping, agriculture, investment, intellectual property rights and environment and labour standards. These issues look to divide members in subsequent negotiations.

³ These show that the philosophy and principles of the WTO are still regarded to be superior to FTAs, though the WTO has lost its uniqueness as the stage of trade liberalisation.

⁴ Krueger (1997: 22) stated that "[i]t is difficult to imagine that a series of overlapping FTAs, with different ROOs (rules of origin) attendant for different countries' access, the need for individual producers to know and keep records for a variety of ROO requirements, and the complications associated with negotiations for accession of additional members, will lead to the WTO-plus world".

it cannot be argued that the FTA complemented the WTO as a whole. It seems that FTAs and the their web do not necessarily ensure smoother economic transactions among countries inside, even if those FTAs go well beyond existing multilateral liberalisation both in depth and width.

Whether the WTO liberalisation and a web of FTAs could be consistent with each other is a very important question for any economies that depend their economic development and stability on the international flow of goods, services and capital. To be consistent with the global free trade that the WTO is ultimately pursuing, FTAs eventually need to become multilateralised and non-discriminating. Do FTAs naturally aim to nullify the meaning of their own existence? It seems not, since each country that participates in FTAs attempts to achieve political and strategic goals, as well as pure economic gains from their respective FTAs. Thus, for FTAs to promote and complement the multilateral liberalisation process some kind of “artificial” mechanisms (or rules, institutions) need to be developed.

In April 2001, a two-year research project was set up at the IDE APEC Study Center to focus on this topic. The basic aims of the project are:

- (1) to identify factors that drive individual countries towards FTAs, even though the move is not necessarily consistent with the WTO principles of multilateralism and non-discrimination;
- (2) to consider “mechanisms” (or rules, conditions) that would make FTAs play a role in complementing and/or promoting multilateral liberalisation process, and;
- (3) to gauge the practicality of these mechanisms.

To achieve these research objectives, it is vital to study the trade policies of countries currently involved in FTA formation. The project is carrying out case studies of Japan, the United States, Thailand, Chile and Mexico. To undertake these case studies, the IDE APEC Study Center invited scholars from outside the institution who already had broad experience in studying the trade policies and domestic policy processes of these respective countries. The case studies are still ongoing at the time of writing, but the preliminary results have been printed as *IDE APEC Study Center Working Paper Series*

01/02 along with this paper, and circulated for comments. Besides these case studies, a review of theoretical literature on the effects of FTAs and the possibility of the FTA “multilateralisation” has been conducted. In addition, the historical development of the concepts of most favoured nation (MFN) status has been studied to draw implications on the current move towards FTAs. Preliminary results of these studies are printed and circulated, too, as the *Working Paper Series*.

This paper aims to lay the foundation for the research project. First, the paper will point out two important aspects of FTAs which should be taken into account when conducting case studies. One is a traditional aspect: key objectives for FTA formation include political and strategic elements that go beyond just gaining economic benefits. The other is relatively new: recent FTAs tend to cover not only the elimination of tariffs and quantitative restrictions on trade in goods, but also the areas not sufficiently dealt with at the WTO. In other words, recent FTAs tend to aim for being “WTO plus”. Second, the paper will discuss “levels” (or places) where the mechanisms of multilateral compatibility may be built in. It will be argued that there are three levels where these mechanisms may be able to exist: outside FTAs (international organisations), within FTAs themselves, and in the domestic politics of FTA participants. Third, the paper will, in a preliminary way, examine the practicability of some types mechanisms according mainly to author’s interview with government officials and business representatives in Australia and New Zealand conducted in November – December 2001.

II. New Characteristics and Objectives of FTAs

Why have so many countries opted to form FTAs in recent years? What do they expect to gain from these FTAs? Can the objectives be achieved only through FTAs? It is essential to study these questions when considering the mechanisms through which FTAs can promote or complement multilateral liberalisation, because they may well have effects on the perceptions of what countries can expect from FTAs.

There is one thing, however, that should be noted before going on to examine these questions. Recent FTAs have a new characteristic, which will also impact on reasons for forming FTAs. Since the 1990s, and particularly during the last several years, FTAs have tended to contain elements beyond the concept of traditional FTAs. Most traditional FTAs, as a main tool for regional (economic) integration until the

1970s, covered only liberalisation of trade in goods, thus concentrating on reducing/eliminating tariffs and quantitative controls between the parties. Following changes in the economic environment (including so-called “globalisation” in the 1990s), however, most of recent FTAs aim to cover broader elements like trade in services, factor mobility, investment rules, intellectual property rights, government procurement and other trade facilitation measures such as mutual recognition of product standards and harmonisation of customs and quarantine procedures. Moreover, some FTAs include the abolition of antidumping and countervailing duties, and emergency protection measures such as safeguards between the parties (World Bank 2000: 80). These elements have not been fully dealt with at the WTO, so they can be called “WTO plus” elements. The reason why FTA parties include these WTO plus elements in their recent FTAs need to be considered as well.

In economic terms, the main objective, naturally, must be to secure mutual preferential access to partners’ markets. By doing that, FTA parties can enlarge the market for their products, thereby yielding better utilisation of economies of scale. Moreover, a larger market and increased number of producers will, more likely than not, induce increased competition. While consumers in FTA parties can enjoy reduced prices of products through more competition, the producers that have survived will gain competitiveness also in the international market outside the FTA because of reductions in inefficiencies. Furthermore, FTAs may assist in attracting foreign direct investment (FDI), if they enlarge the market considerably. These economic gains expected from FTAs are noted in almost all of the literature on FTAs. Broad coverage of WTO plus elements would enhance these gains, if introduced, since the new elements will promote a “deep” integration of economies of the FTA parties. A deep integration minimises the remaining trade restrictions other than tariffs and quantity controls between the parties, and substantially assures market enlargement and more intra-FTA competition.

Can these economic gains only be achieved through bilateral/regional trade agreements such as FTAs? Some multilateralists argue that, since an agreement was reached to launch a new round of trade negotiations at the WTO Ministerial Conference in Doha in November 2001, there would be no need to further pursue bilateral/regional

trade agreements for the time being.⁵ If the objectives of FTAs were confined only to economic gains mentioned above, their argument may well be valid since the effects of multilateral liberalisation (or even unilateral liberalisation) would deliver almost all expected economic gains from FTAs. However, there are political and strategic motives as well for each FTA, which may be more important than these economic gains.

The World Bank (2000: 12-25) lists some political objectives of FTAs, namely: promoting security; strengthening bargaining power; and locking in reform policies. First, the security objective seems to be based on traditional notions that: regular contacts between political leaders and government officials on economic issues will build mutual confidence; and that deep economic interdependence makes war materially impossible.⁶ The best example is the European Union (EU). It is a well-known fact that the main reason for establishing the European Coal and Steel Community (ECSC), the predecessor of the European Economic Community (EEC), the European Community (EC) and the EU, in 1951 was to create a community that would avert internal wars by collectivising essential goods for economic activities.

Second, if small- and/or middle-sized countries (such as Singapore, Thailand, Australia, New Zealand, Argentina and Brazil) could form FTAs, they may be able to strengthen their bargaining power against bigger countries (such as the United States, the EU, Japan and China), or at multilateral negotiation tables (such as the WTO and APEC). Even if they could not acquire substantial bargaining power by forming FTAs, they can at least expect a better chance of being noticed (World Bank 2000:19). In addition, a political motive for covering WTO plus elements in FTAs, particularly those that aim at setting new rules on investment, intellectual property rights, labour and/or environmental standards, e-commerce, competition policy, finance and others, may arise from this “bargaining power” perspective.⁷ By setting new rules on these WTO plus issues in FTAs, the parties involved could obtain not only freer trade between them but also a better negotiation position at the WTO. If the FTA parties are influential enough, they may be able to make their “local” rules into “international” rules through multilateral negotiations. To become influential enough, it seems, FTA parties need to

⁵ Interview with Australian academics in Canberra and Sydney. 6 and 11 December 2001.

⁶ See, for instance, Haas (1958), Deutsch (1967) and Keohane and Nye (1977).

⁷ Rajan, Sen and Siregar (2001: 8) pointed out that “FTAs could act as testing ground for exploring complex trade issues and may help establish some sort of precedent for multilateral negotiations”. However, they did not elaborate “how”.

include at least one economic power (such as the United States, the EU or Japan) which can set one of the main rules, and strategically mobilise others who would accept their rules and form a coalition at multilateral negotiations. All these, however, are dependent on the condition that FTA parties could find a common stance and negotiate as a single entity.⁸

Third, countries undergoing the process of economic adjustment can use FTAs for the purpose of “locking in” their reform agenda. “Adjustment to reform typically involves investments, but these investments will not be made unless investors are confident that reform will persist. ... If the investments are not made, then government is likely to face increasing pressure to reverse the reforms. ... To escape from this trap governments often need institutions that enable them credibly to lock in to decisions. These are sometimes referred to as *commitment mechanisms*” (World Bank 2000: 23). As FTAs are international treaties that require the formal procedure of domestic ratification, they would work as the international commitment mechanisms for the reform of domestic economies. Domestically, traditionally strong opposition to reform policies from particular economic sectors can be expected to be offset by sectors supporting reform. The case of Mexico joining the North American Free Trade Agreement (NAFTA) is a good example. The Mexican government started to reform its economy in mid 1980s, and NAFTA was seen both by the Mexican and US governments as a follow up step to lock in the reform policies (World Bank 2000: 24-5; Rosas 2002: 16-25). Even a non-economic reform agenda such as democratisation can be locked in through FTAs as the South American Common Market (Mercado Común del Cono Sur, MERCOSUR) demonstrated (World Bank 2000: 23-4). This locking in objective, however, can be achieved by making active commitments in multilateral settings (WTO) and/or through unilateral liberalisation. The reason that some countries prefer FTAs to multilateral/unilateral liberalisation for this purpose seems to lie in their domestic politics. By choosing suitable partner(s), a country may expect to lock in the reform agenda in a “soft” way through controlling competition that would increase. For instance, one of the Japanese government’s rationales for signing an FTA with Singapore was to advance its structural adjustment policies. Singapore was the most

⁸ In the case of customs unions (CUs), finding common stances on negotiated issues may be easier than FTAs as CUs adopt uniform external tariff rates. In addition, it is also likely than not that they employ common policies on trade in services, factor mobility, customs procedure and product standards.

suitable country for Japan to establish an FTA with because it did not have large agricultural, forestry and fisheries sectors, which were, and still are, the strongest proponents of protectionism in Japan. Thus, it is not surprising that the Japanese government resolved that the political and economic consequences of multilateral or unilateral liberalisation were too severe and, by negotiating the FTA with Singapore, it aimed at locking in the reform policies while protecting vested interests at the same time.⁹

In sum, since there are number of objectives and combinations of objectives for FTA formation, every FTA and FTA party should be considered to have different objectives and motives. Also, it should be noted that political and strategic objectives are important factors that drive countries towards FTAs. Therefore, it should be seen that the trend of FTA formation will not die down just because a new round of trade negotiations has been launched.

No FTA is formed for purely economic reasons only; and all FTAs have different mixes of political and strategic objectives as determined by the preferences of individual countries. Differences in the contents of every FTA arise from the different foreign policy strategies and domestic politics of the parties negotiating individual FTAs. For instance, the content of an FTA that country A signed with country B may well differ from that which A signed with country C, reflecting the foreign policy strategy of A based on its domestic political and economic circumstances. Moreover, the motives and policy objectives of each party in the same FTA can differ. In other words, what countries A and B attempt to achieve from the A-B FTA could differ, even though they are obliged to comply with the same articles of the same FTA.

Thus, the relations between FTAs and the multilateral liberalisation process, and the mechanisms through which FTAs can promote and/or complement multilateral liberalisation cannot be examined fully without analysing domestic policy preferences

⁹ The problem with this kind of attitude is that the FTA signed may not work as an effective commitment mechanism, since foreign investors other than those in the FTA partner(s) may not have confidence in the government's intentions. In Japan's case, for instance, investors in the United States or the EU might not believe that the Japanese government had "locked in" reform policies, even though the FTA with Singapore was signed. Furthermore, World Bank (2000: 25, 66) argues that, for the policy lock in objective to work, it needs to be supported by the credible and effective sanctions from partner(s). If the perceived cost of breaking FTA commitments were low, there would always be an incentive to do so. In this regard, too, the FTA with Singapore may be seen as a weak commitment to lock in reform policies, compared with other potential FTA with, say, the United States.

of individual parties to FTAs from political economy perspectives. After all, any negotiations inevitably involve the strategies and domestic politics of the participants. The mechanisms that our research project is seeking would not function if they are not ultimately supported by the domestic politics of FTA parties. Consequently, in reviewing trade policies of respective countries, the case study papers for our research project need to address factors such as: how much influence the norm for action (the more multilateralised and the less discriminatory, the better) will have on each domestic constituency; who would benefit from a particular FTA with certain partner(s) and who would not; and whether the beneficiaries, or non-beneficiaries, of FTAs could form a domestic coalition that prefer the multilateralisation of FTAs naturally.

III. Considering the “Mechanisms” for FTAs

Taking into account the diversity of motives and objectives for FTAs, and the importance of political/strategic factors in particular, this section will try to categorise the mechanisms for FTAs that would make them promoters of multilateral liberalisation.

In logic, there are two types of mechanisms through which FTAs can play a role in complementing/promoting the multilateral liberalisation process. First, FTAs could be multilateralised in terms of their membership. The multilateralisation of FTAs could be achieved by accepting new members into each FTA, or by merging regional FTAs such as NAFTA, AFTA and MERCOSUR. These two processes can happen at the same time until, theoretically, they cover the globe. Second, FTAs could become less discriminatory if their content was gradually applied to non-members. In terms of tariffs, for example, if FTA parties gradually reduced external (MFN) rates unilaterally, or in concert, the level of discrimination would be lessened. On the other hand, the application of other FTA rules, such as rules of origin, to non-members would require consensual decision and implementation between the parties.

Again in logic, the mechanisms can be set at several “levels” (or places):

- (a) outside FTAs (within international organisations that contain FTAs and their parties);

- (b) within FTAs themselves (building-in the mechanisms in the FTA articles),
and;
- (c) within each FTA party (domestic policy making institutions).

Setting the mechanisms at the level (a) implies strengthening the power of the international organisations that cover wide geographical areas, such as the WTO and APEC, to control FTAs.¹⁰ Also, measures to promote comprehensive and speedy multilateral liberalisation in the WTO round can be seen as such a mechanism, as it would reduce the *raison d'etre* of FTAs (preferential trade between the parties). Level (b) involves preparing mechanisms within the FTAs' articles that will have, in the future, the effect of multilateralising FTAs and/or making FTAs less discriminatory. For instance, an "open accession (membership)" system that will assure easier accession of new members could be included as a mechanism to multilateralise FTAs, and, as mentioned earlier, the gradual reduction of MFN tariff rates (in other words, concerted liberalisation of external tariffs by FTA parties) and/or rules of origin requirement could be considered as means to making an FTA less discriminatory. Level (c) involves the question of whether the domestic politics of individual FTA parties could support multilateral liberalisation and/or the multilateralisation of FTAs, and allow the mechanisms to be set at levels (a) and (b). If the domestic politics of some FTA parties were to allow such mechanisms, then the way to align a coalition of those parties must be established to form a critical mass in the international level. Otherwise, the parties with the intention of multilateralising their FTAs would be disadvantaged by free riding. On the other hand, if the politics of individual parties do not allow the mechanisms, how the domestic policy making "institutions", in a broad term, can be adjusted to redirect the policy preferences of domestic constituencies should be studied. This may include the provision of incentives through some kinds of side-payments. In any case, it will be necessary to study current policy making institutions of each party in historical perspective, for the purpose of understanding individual parties' attitudes toward the

¹⁰ GATT Article XXIV already put certain conditions on any FTAs to be signed by developed economies. In reality, however, FTA parties can interpret those conditions relatively freely and, as a result, FTAs with a wide variety of contents have emerged. Moreover, since it failed to judge the first case of the EEC as inconsistent with the GATT principle (World Bank 2000: 109-10), the GATT/WTO system has lost the ability to determine which FTA is WTO consistent and which is not. Furthermore, the Article XXIV does not necessarily apply for preferential trade agreements between developed and developing economies (i.e. the Generalised System of Preference) and FTAs between developing economies (i.e. the Enabling Clause, World Bank [2000: 119]).

multilateralisation of FTAs fully.

According to the discussion so far, the mechanisms to multilateralise FTAs and to make them less-discriminatory can be categorised as shown in the Table.

Table: Categorising the “Mechanisms” for FTAs

Levels \ Types	Multilateralising	Making Less-discriminatory
Level (a) -outside of FTAs-	<ul style="list-style-type: none"> - Comprehensive and fast WTO liberalisation. - Strengthening the WTO’s power to control FTAs. - Periodical review of FTAs by the WTO and/or APEC. - Binding APEC FTA guidelines. - Creation of an international environment that facilitates FTA multilateralisation. - Provision of international incentives to opposition. 	<ul style="list-style-type: none"> - Comprehensive and fast WTO liberalisation. - Strengthening the WTO’s power to control FTAs. - Periodical Review of FTAs by the WTO and/or APEC. - Binding APEC FTA guidelines. - Creation of an international environment that help make FTAs less-discriminatory. - Creation of the mechanism that picks up certain FTA contents for the multilateral agenda. - Provision of international incentives to oppositions.
Level (b) -within FTA articles-	<ul style="list-style-type: none"> - Open membership (accession). - Making contents of FTAs identical with each other. 	<ul style="list-style-type: none"> - Gradual reduction of external tariffs. - Gradual application of FTA contents to non-members.
Level (c) -domestic political institutions-	<ul style="list-style-type: none"> - Realignment/adjustment of policy making institutions to allow the mechanisms. - Provision of domestic incentives to opposition. 	<ul style="list-style-type: none"> - Realignment/adjustment of policy making institutions to allow the mechanism. - Provision of domestic incentives to opposition.

Source: Author.

It should be noted that the levels (a), (b) and (c) do not exist independently. Rather, they must be strongly connected to each other for the mechanisms to function. Thus, the combination of levels (a), (b) and (c) should be brought into consideration. For example, if the power of international organisations to control FTAs is to be strengthened to enable measures such as the rigorous application of Article XXIV and the introduction of binding “APEC FTA guidelines” that may include a regional multilateralisation clause, support from most members is naturally and essentially required. The same

support is needed to make the WTO round, or the APEC liberalisation process, comprehensive and speedy. In the process of getting support from individual FTA parties, some kind of incentives would be needed ([a] [b] [c] or [a] [c] [b]). If the clauses to multilateralise an FTA and/or make an FTA less discriminatory are to be built into the FTA itself, the international environment should be prepared to assure those FTA parties will be advantaged, or at least not be disadvantaged, by the clauses ([b] [a]). One of the best ways to do this is to encourage more and more parties to include the clause in their own FTAs. To create these dynamics, the restructuring of domestic political institutions will be necessary ([b] [c] [a]). Furthermore, focusing on individual FTA parties, the possibility of realignment/adjustment of domestic policy institutions will have a significant impact on prioritising multilateral (WTO) liberalisation ([c] [a]), making the contents of their FTAs as identical as possible to avoid the spaghetti bowl effect, and allowing the “open membership” system and/or the merger of their FTAs to occur ([c] [b] [a]).

IV. Preliminary Arguments on the Practicability of the Mechanisms

This section presents some preliminary arguments on the practicability of the FTA multilateralisation mechanisms and on mechanisms for making FTAs less discriminatory. This will be an introductory exercise for the case studies that will follow this paper, based on the interviews and discussions the author had with government officials, staff of industry groups and academics in Australia and New Zealand in November – December 2001. A general impression from the interviews was that the connection between FTAs and multilateral liberalisation was not seriously thought about both in Australia and New Zealand. In other words, they are negotiating their FTAs according to their own policy preferences and strategies, though they share the notion that multilateral (WTO) liberalisation is the best option for their economies and, thus, FTAs are the “second best” option. To find the ways to promote, or complement, multilateral liberalisation through FTAs seemed not to be on their policy agendas.

IV-1. Multilateralisation of FTAs

New Zealand has already signed an FTA with Singapore (called the Agreement between

New Zealand and Singapore on a Closer Economic Partnership, CEP) in 2000, which has been in effect since early 2001. The CEP covers not only trade in goods and services but also the WTO plus elements of competition policy, customs procedure, investment, mutual recognition of products and quarantine standards, government procurement, intellectual property rights and dispute settlement. Australia is now in the final stage of FTA negotiations with Singapore. Though the clear design of the FTA was not available at the time of interviews, the Australian government insisted that they were working to make the FTA with Singapore as a “benchmark” for FTAs that it might sign in the future, by including WTO plus elements as much as possible.¹¹

Both Australia and New Zealand had the intention of making their FTAs as comprehensive as they could, and Singapore was the most appropriate partner for them to realise their intentions. Here a question arises. If Australia and New Zealand were pursuing the same kind of FTAs with Singapore, why did they not aim at forming an FTA comprising those three members from the start? In fact, Australia and New Zealand have had an FTA between them since the early 1980s called the “Australia and New Zealand Closer Economic Relations Trade Agreement” (CER), which has been rated one of the most WTO consistent FTAs in existence. It should have been natural to expect Australia and New Zealand to invite Singapore into the CER or to negotiate an FTA between Singapore and CER, because it would have significantly reduced negotiation costs. For Singapore, too, negotiating with the two countries at the same time would have reduced the costs incurred in negotiating with them separately. Why, in reality, did this not happen?

To jump to the conclusion, it was because there existed (small) differences in Australia’s and New Zealand’s trade policies (or domestic policy preferences), including the timing of the start of negotiations and what they expected to achieve from FTAs with Singapore. For example, the New Zealand-Singapore FTA (CEP) lists the coverage of goods and services in the “positive listing” system, which means that the products listed are covered by CEP but all those not listed are excluded. The Australian government did not like this approach and insisted on using the “negative listing” system of product coverage, and the Singapore government accepted.¹² Through

¹¹ Interview with the Department of Foreign Affairs and Trade (DFAT) officials who were in the FTA negotiation team with Singapore, 5 and 7 December 2001.

¹² *Ibid.*

negative listing, the products listed are excluded from coverage, but all those not listed are covered. The level of comprehensiveness will depend on how many products are listed in both listing systems, but generally, the negative listing system tends to be more comprehensive in nature. In addition, when negotiating an FTA with New Zealand, Singapore did not offer more commitments than it had made in the Uruguay Round, a position accepted by New Zealand. Singapore offered the same commitment to Australia at first, but the Australian government was not satisfied and asked for more WTO plus commitments in services from Singapore.¹³ The fact that Australia and New Zealand, which share similar history and trade policy preferences, are located in the same geographical area, and have a comprehensive FTA between them, could not as an entity negotiate an FTA with Singapore may be an evidence of the difficulty of multilateralising FTAs.

Negative responses are often heard on the idea of multilateralisation of FTAs through an “open membership” system.¹⁴ In many cases, it is possible for FTAs to accept new members,¹⁵ but it is more likely that negotiations would take place between the original parties and the country that wanted to join the FTA, before the latter could be accepted, or a new FTA consisting of original members and the new comer would be formed. NAFTA and the Free Trade Agreement of Americas (FTAA), which is under negotiation, are good examples of the formation of new FTAs.

As the reason for why the simplest form of open membership system is hard to apply in reality, many interviewees emphasised that an FTA was a “symbol” of the political will of the participating parties.¹⁶ For countries that want to join an FTA late, the open membership system implies that they must agree on literally everything written into the existing FTA, thereby accepting all of the political preferences of the original parties. It would be very rare for a sovereign state that has its own political, economic and social characteristics to agree to that. On the other hand, for the original parties to an FTA, the content of the existing agreement must be the “best” available, reflecting

¹³ *Ibid.*

¹⁴ A Membership will be almost automatically accepted if a third country agrees to fulfil conditions required by the FTA clauses.

¹⁵ Most of recent FTAs have an accession clause. For instance, see the New Zealand-Singapore CEP.

¹⁶ Interview with staff of two different business organisations, in Wellington in 29 November 2001 and in Auckland in 3 December 2001; with an academic of the University of New South Wales, Sydney, 10 December 2001; and with DFAT officials, *op.cit.*

their economic/trade structures (such as their main exports and imports in goods and services, and the investment flows including FDI) and domestic political circumstances (such as the protection of sensitive sectors). More or less, the accession of new members would inevitably change the balance. If the new membership is perceived to disadvantage certain economic sector(s) of the original parties,¹⁷ there would be a serious need to revise the existing agreement to allow new entries. In sum, the open membership system cannot easily be accepted both by the original members of an FTA and countries that want to join the FTA.¹⁸

An interesting point was raised by some of the interviewees that the way the EU accepts new members might be similar to the open membership system. Surely, as far as the author is aware, the basic treaties of the EU (EC), such as the Rome, Maastricht and Amsterdam Treaties, were not to be amended just because new members joined the organisation.¹⁹ ASEAN may be a comparable case. Vietnam, Myanmar, Laos and Cambodia committed to AFTA when they became members of ASEAN, but AFTA, or the Common Effective Preferential Tariff scheme to be precise, itself was not amended due to new members, except in allowing longer implementation periods for new members.

What the EU and ASEAN have in common is that they both have trade (and investment) agreements designed for specific geographical areas. In addition to the objective to improve economic welfare levels of members through the promotion of intra-regional trade and investment, they both have the political/strategic objective of building a “community” in their respective regions. Thus, it should be noted that in both cases, expansion of membership is virtually limited within their respective geographical areas. It is still unclear how many more members will be allowed in the EU as the number of applications increased after the end of the Cold War, but the possibility of the increase in members in ASEAN from the current ten is almost none, unless new states are formed in the region.²⁰ The multilateralisation of AFTA by increasing membership

¹⁷ For instance, the cheaper labour and environmental standards of Mexico perceived to be problems when the Canada-US FTA was dissolved to form NAFTA.

¹⁸ This implication would also apply when considering the merge of FTAs.

¹⁹ The World Bank (2000: 100), on the contrary, argues that the full membership in the EU is hardly open membership. It indicates that the United Kingdom had to ask three times before it was allowed to join, and Turkey was rejected until recently. It also points out that negotiation took time even after the accession was accepted in principle.

²⁰ East Timor may join ASEAN in the near future.

has virtually stopped and the next step, if there is one, would be the formation of new FTAs with extra-regional partners like Japan, China and Korea. Whether the motives of “regional” FTAs can be brought into the next step (bringing extra-regional members into a regional FTAs, or merging regional FTAs with another) is crucial, and different incentives than before may be necessary.

Attempts to give each FTA an identical content could result in avoiding the spaghetti bowl effect and inducing the merger of FTAs.²¹ For instance, if the A-B FTA and the A-C FTA have the same tariff rates on the same products, the same rules of origin, investment rules and so on, industries in country A would face just two sets of tariff rates and rules: MFN and FTA. At the same time, it can be assumed that the countries A, B and C have a better opportunity to form a new A-B-C FTA than they would if the A-B and A-C FTAs had very different contents. Countries that attempt to make all of their FTAs have uniform contents already exist. Australia, as mentioned earlier, is trying to make its FTA with Singapore a “benchmark” (though the prime motive is not exactly the multilateralisation of the FTA). Domestic industry groups in Australia are also supporting the attempt.²²

If many countries perceive a certain FTA as very successful, they may imitate it for their own FTAs as a model. This “demonstration” effect²³ could homogenise the contents of multiple FTAs. In that case, the recognition of “success” of the preceding FTA needs to be widely shared across the world. The problem is that what will be perceived as “success” may differ from country to country. Depending on the power balance of the domestic constituencies, some countries may find a comprehensive FTA as a success while others may see effective protection of certain sensitive sectors as a success. To lead subsequent FTAs towards the direction of the multilateralisation of FTAs, the “model” FTA that is to be imitated needs to have a high level of WTO consistency. However, that is not assured in many ways. There is always a risk that an FTA with a relatively low level of WTO consistency is widely imitated by the following FTAs due to some combination of political factors. If that happens, FTAs could be homogenised in a direction opposed to the WTO principles.

²¹ The creation of FTAs with identical contents itself, however, is not really the multilateralisation of FTAs because there remain walls between them

²² Interview with a principal advisor of an industry group, 6 December 2001.

²³ Baldwin (1995) described similar effects in Europe as the “domino regionalism”.

IV-2. Gradual Application of FTA Contents to Outsiders

On the concept of reducing the discriminatory feature of FTAs by applying their contents gradually to outsiders, most of the interviewees argued that the possibilities would differ between the traditional elements of FTAs and the new (WTO plus) elements.

Its practicability for the traditional elements of FTAs, they argued, was almost zero. Both Australia and New Zealand were very cautious of trade liberalisation without reciprocal actions by others and are seriously concerned about the free riding problem. However, on the other hand, because of the unilateral and the GATT/WTO commitment based liberalisation that Australia and New Zealand have undertaken for the last twenty years, the margin between CER tariff rates and the MFN tariff rates has significantly reduced. In other words, the CER has almost lost its meaning in the area of trade in goods.²⁴ Some argued that, in the future, remaining elements of the CER might also lose their meaning in the same way as trade in goods has, and this tendency would apply for other FTAs signed or negotiated recently. If so, they argued, there would be no need to create mechanisms to apply contents of FTAs to outsiders, with their substantive costs and risks.

Against this argument, a point could be made that there is no guarantee that all countries will act exactly as Australia and New Zealand did. Surely, the tendency can be observed that trade liberalisation will eventually go ahead when the domestic economy develops. Good examples of this are what Japan, Asian NIEs and ASEAN countries did in the past when their respective GDP growth rates surged. However, the level and the pace of unilateral liberalisation may well differ from one to another, reflecting, again, domestic policy preferences. Australia and New Zealand had to spend almost twenty years in reaching the level of liberalisation where CER does not have much meaning in trade in goods. Even if it is assumed that parties of FTAs recently signed or negotiated, developing economies in particular, could act just like Australia and New Zealand, it will be not before the 2020s that the traditional elements of their FTAs lose its meaning. This may not be soon enough as a complicated web of FTAs seems set to emerge by the

²⁴ Relatively large margins between the CER and MFN tariffs remain in the textile, clothing and footwear sector in both countries, and in the automotive and parts sector in Australia.

end of this decade.

In contrast, many stated that the extraterritorial application of new (WTO plus) elements of FTAs might be easier than the traditional elements. For parties to an FTA that attempt to set “WTO plus” rules (on investment, finance, intellectual property rights, e-commerce, etc.), it would be better if those rules were applied in wider areas than just within their own FTAs, because it would reduce transaction costs significantly. There emerges an incentive to apply rules set in FTAs extraterritorially. For instance, WTO plus elements are emphasised in the Japan-Singapore FTA (called the Economic Agreement for a New Age Partnership), which was signed in January 2002, and it seems there is no reason for both Japan and Singapore to prevent participation of other countries in these rules. In fact, when he toured Southeast Asia in January 2002, Prime Minister Koizumi proposed new economic cooperation initiatives that included comprehensive economic partnership agreements with ASEAN countries. The plan does not exclude other countries in the region such as Korea, China, Australia and New Zealand and the wider application of WTO plus rules is most likely to proceed.²⁵ In addition, Singapore seems to have attempted to coordinate those WTO plus rules which were to be included in both FTAs with Japan and Australia as the negotiations with these two countries went ahead simultaneously. This can be seen as a sign of the practicability of extra-FTA spill-over of WTO plus elements. Furthermore, there is an initiative called the “Trade and Investment Facilitation Agreement” (TIFA) between Japan and Australia. Details of TIFA are still unknown but it is likely to cover WTO plus elements, too. If coordination among Japan, Singapore and Australia goes smoothly and positively, it may become a model case of the wider application of the WTO plus elements of FTAs.

It may be necessary, however, to examine more carefully whether it is possible and/or appropriate to separate traditional and new elements of FTAs. It is likely that the practicability of spill-over of WTO plus elements would also depend on domestic political economic circumstances, just like traditional elements do: which constituencies will benefit, which constituencies will be disadvantaged and the nature of the political

²⁵ Provided the facts that Japan did not touch upon agricultural, forestry and fisheries products in the FTA with Singapore in effect even though Singapore was not a major exporter, and most of other ASEAN members are exporters of those products, the proposed plan of the Japan-ASEAN Partnership Agreement is expected to exclude agricultural products, or at least treat those products differently from others.

power balance between them. It should be remembered that opposition to the universal application of the new rules on investment and intellectual property rights already exist at the WTO level, mostly from developing economies. Ultimately, in the future, some kind of global standards for the current WTO plus elements are expected to emerge, but it may not be very soon.

IV-3. Using Institutions outside FTAs

If the WTO round of trade negotiations, or the APEC liberalisation process, steadily proceed and the commitments agreed to are implemented by each member without delay, there would be no need to worry about the potential adverse effects of FTAs and a web of FTAs. A credible WTO (or APEC) liberalisation process can be expected to have effects of multilateralising the contents of FTAs. Due to the reality that the number of FTAs is increasing without much progress in multilateral liberalisation, however, the point is how FTAs, which are basically exceptions to the WTO principles, can play a role to promote the WTO (or APEC) liberalisation process.

In Australia and New Zealand, every interviewee urged the necessity of the early launch and fast conclusion of the new WTO round. There was not a difference in opinions on this point between supporters of and opposers to FTAs. Government officials who were in charge of FTA negotiations in both countries recognised the risk of FTA formation while the WTO liberalisation process is stalled.²⁶ For instance, they seemed to recognise that the number of their potential FTA partners were very limited if they continued to pursue comprehensiveness and the “WTO plus-ness” in their FTAs. If they were to sign FTAs with Japan or the United States, the two major trade partners for both countries, the agreement would have to have flexibility in some parts (most likely in agriculture). In other words, their FTAs with Japan or the United States, if signed, may include some parts that may be vague in terms of WTO consistency. Australia and New Zealand could expect, however, that these aspects will be dealt with in multilateral liberalisation process if the WTO round runs simultaneously. Parallel negotiations at the WTO and FTAs could also reduce the adversary effects when others formed an FTA that contained unfavourable contents to one country. For example, the Japan-Singapore

²⁶ For Australia and New Zealand, the formation of FTAs in the East and Southeast Asian regions in which they cannot participate is the biggest foreign policy concern. Interview with government officials in New Zealand (30 November 2001) and Australia (5 and 7 December 2001).

FTA, which virtually excluded agricultural products, may bear a quite unfavourable demonstration effect for Australia and New Zealand. However, as the negotiations on agricultural trade at the WTO have been in progress since 2000 and included in the new round (and Japan has committed to the negotiation), the impact of the Japan-Singapore FTA on agricultural trade can be reduced.²⁷

On the other hand, those who oppose FTAs seemed to consider the discriminatory feature of FTAs as the most problematic and believe multilateralisation of FTAs and/or making FTAs less discriminatory are impossible once they are formed. Thus, they assert that each country should spend its scarce negotiation resources only on the WTO process.²⁸ For them, the results of the APEC Ministerial and Leaders Meetings in Shanghai in October 2001 and the launch of new round at the WTO Ministerial Conference in Doha in the following month were good signals. They seemed to judge that promoting WTO and APEC liberalisation was the only way to counter the harmful effects of FTAs.²⁹ The problem is that most of these anti-FTA arguments do not contemplate any other options than to stop negotiating FTAs.

Other than the demonstration effect mentioned earlier, strengthening the power of international organisations to control FTAs can be seen as a mechanism to make FTAs highly consistent with the WTO principles and rules, and spilling over their contents to outsiders in the future. At the WTO, the conditions covering FTA formation should be more clearly stated in GATT Article XXIV, and the Committee for Regional Trade Agreements (CRTA) should be given more power to oversee FTAs effectively. At APEC, the Bogor goals should be re-stated to make what they wish to achieve clear. Also, binding commitments should be brought in to raise the reliability of APEC and the APEC liberalisation process.

In reality, Article XXIV was clarified in 1995 when the WTO was created, but the number of FTAs with varying contents has been increasing dramatically since. In

²⁷ In this regard, however, the launch of the new WTO round may stimulate “not-so-WTO-consistent” FTAs to be formed. Countries looking to FTAs may avoid tackling difficult issues in their FTA negotiations, considering that they will be dealt with at the WTO. This also implies that it may imply that, during the period when the WTO round is underway, the number of FTAs signed or negotiated might increase.

²⁸ “Time and efforts spent on negotiating and implementing a series of bilateral and trilateral FTAs may divert scarce resources from the multilateral rounds” (Rajan, Sen and Siregar 2001: 72).

²⁹ Interview with different academics and ex-government officials in Canberra and Sydney. 6, 7 and 11 December 2001.

APEC, as recently as last year (2001), a New Zealand ABAC member tried to establish “non-binding principles” for FTA formation, but failed.³⁰ It is often argued that the most realistic way to make FTAs consistent with the WTO is by using the WTO and APEC. With the current set up of both organisations, however, all that can be done is just to ask members to act in accordance with their philosophy, norms or principles, and the reality shows that is not enough. Countries negotiating FTAs can decide what kind of contents they want in their FTAs, displaying some respect for the WTO and APEC principles, and third countries’ opinions cannot expect to have much impact. Those who have substantial influence in making FTAs consistent with the WTO are domestic constituencies (both exporters and importers, producers and consumers) within those countries, and the final decision by governments will be made according to the power balance between them.

Alternatively, it may be more feasible to consider permanent mechanisms to multilateralise the contents of FTAs that already exist, by using organisations outside of FTAs. In particular, it may be worth considering a mechanism that sends the rules on the WTO plus elements of FTAs directly to an organisation like the WTO for multilateralisation. This is not a measure to negotiate the application of those rules with third countries or other FTAs as was mentioned earlier. Rather, it is a direct way to make those rules applied widely. An Australian International Relations scholar pointed out that, if it is true that trade liberalisation is like “riding a bicycle”,³¹ any liberalisation attempts, including FTAs, have chance of being picked up as the WTO agenda. The question is how to design and create a mechanism, which does not readily exist, to bring contents of FTAs to the WTO.

For the WTO to pick up some contents of FTAs that have already recognised as “de facto” standards will be relatively easy. In reality, what the WTO can pick up from FTAs will be, more likely than not, the least common denominator of all contents of existing FTAs. In other words, they will be measures that are so fundamental that every FTA includes them. Having said that, the contents of FTAs in which Powers (such as the United States, the EU and Japan) participate could have more chance of being

³⁰ Interview with a support staff of a New Zealand ABAC representative, 29 November 2001.

³¹ Interview, 10 December 2001. It is often described that trade liberalisation will break down if it is not continuously pushed.

multilateralised through the WTO even if they were not necessarily perceived as de facto standards, since the Powers may push them, probably with some allies, to gain advantages for their domestic industries. For instance, if new investment rules or new rules to protect intellectual property rights were agreed in an FTA including the United States, they may have more chance of becoming global rules than those agreed by less powerful, smaller countries. In those cases, a small country that opposes the rules to be applied universally would need to form a coalition with others that share the same policy preferences. Smaller countries, in particular, need to accumulate support at the WTO, not only to oppose the Powers but also to get the contents of their own FTAs picked up onto the WTO agenda for multilateralisation. Those attempts to accumulate support to form a “critical mass”, and the institutionalisation of those attempts (including international/domestic provision of incentives and/or side-payments), could be seen as one of the mechanisms for multilateralising FTAs.

V. Concluding Remarks

Since this paper aimed to be an introduction to the research project, which is currently underway during the period of 2001 – 2002, it pursued the following tasks:

- (1) Of setting the general questions that the research project examines. In economic theory, global free trade will maximise welfare of both a country and the world at the same time, and the GATT/WTO system has been working relatively well for the purpose of “freer” trade in “wider” areas. However, since the 1990s, the number of FTAs has been dramatically increased and a complicated “web” of FTAs may gradually emerge. FTAs and the web of FTAs do not necessarily assure smoother economic transactions among countries within them. Though the new WTO round has been launched in 2002, it may not have much impact on the trend of FTA formation because each FTA party has important political and strategic objectives advanced by their FTAs. Thus, some kinds of mechanisms (or rules, institutions) need to be introduced if FTAs are to promote and complement multilateral liberalisation.

- (2) Of examining an important characteristic of recent FTAs, and its influence on general objectives of FTAs. Recent FTAs tend to include “WTO plus” elements that are not sufficiently covered by the WTO process, and aim for “deep” integration. These include trade in services, rules on investment, intellectual property rights, e-commerce and other trade facilitation measures. Traditional objectives of FTA formation can be divided into economic and political/strategic. It is important to note that political and strategic objectives have significant meanings for each FTA party. The WTO plus elements will enhance both economic and political/strategic objectives by making economic transactions between the parties freer, and contributing to strengthening their negotiation positions at the WTO and broadening the area in which their own rules are applied.
- (3) Of indicating possible “mechanisms” and categorising them. In logic, there are two ways to make FTAs to promote/complement multilateral liberalisation: multilateralising FTAs by increasing the number of participants; and applying the contents of FTAs to outsiders. Again in logic, there can be three levels (places) in where those mechanisms could be set (see Table). No matter what the types of the mechanisms are, or in what levels the mechanisms are placed, it is important that they need to be supported by the domestic politics of each FTA party. In addition, an international environment that will facilitate the mechanisms is required.
- (4) Of introducing some arguments on the practicability of possible mechanisms, based mainly on interviews conducted at the end of 2001 in Australia and New Zealand.

This paper is an interim report of the two-year research project. As mentioned earlier, preliminary results of the case studies on Japan, the United States, Thailand, Chile and Mexico are also printed along with this paper. The project will be carried on in 2002 for intensive discussion on the preliminary results. After the discussion, each paper will be revised and edited for publication as a volume in 2003. Comments on this paper, and others in the *Working Paper Series*, are most welcome.

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