

Free Trade Agreements and the Multilateral Trade System

FTA and WTO/Harmonization
/Developing Countries/Environment

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1. Proliferation of FTA

- In 1990, 27 FTA, in 2007, 205 FTA were registered in WTO and about one half of them were formed after 2001.
- Big FTA/RTA – EU, NAFTA, MERCOSUR and ASEAN
- FTA as a whole has as much impact on world trade as the multilateral trading system
- Recent moves in East Asia – Korea, Japan, China and ASEAN – ASEAN+3, ASEAN+6
- Japan entered or negotiating FTA with such countries as Singapore, Mexico, Malaysia, Thailand, Indonesia, Vietnam, Australia, Switzerland.

2. Why FTA?

- Failure of multilateral negotiations at the WTO
- Failure of Ministerial Conference in Seattle (1999), Cancun (2003) and Hong Kong (2005)
- FTA, BIT, RTA and EPA are the only way to cover new areas (the Singapore Issues such as investment, competition policy, environment, energy and others).

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- Geographical proximity and economic interdependence (NAFTA, EU, MERCOSUR etc)
- Common historical and cultural heritages
- Diversification and market access (Japan-Mexico)
- Access to natural resources (Australia-Japan)
- Compromise between multilateralism and bilateral/regional need

2. Legal Status of FTA in WTO

- Exemption of FTA from GATT disciplines
- Key provisions of Article XXIV of the GATT
- Article XXIV:4 – general principle
- Article XXIV:5 – conditions for FTA
- Article XXIV:6 – tariff negotiation
- Article XXIV:8 – Definition of customs union and FTA

“Substantially all” requirement

- Article XXIV: 8 of GATT
- Is substantially all a quantitative or qualitative test?
- Working Parties Reports
- No conclusive interpretation yet but important views maintain that both qualitative and quantitative tests should be used and no important sector (such as agriculture) should not be left out altogether.

“Shall not be on the whole higher or more restrictive than before”

- Article XXIV:5 (a)
- Tariffs→ weighted average
- Other restrictions are more difficult to judge, especially rules of origin.
- On the whole→ There is room to interpret that some restrictions heavier than before can remain.

Plus and Minus of FTA

- WTO Plus→ investment, competition policy, environment, energy, labor etc
- WTO Minus→ Exclusion of outside parties and distortion of trade and investment.
- Preemption of natural resources
- Question is how to maximize WTO Plus and minimize WTO Minus.

3. Areas Covered by FTA

- (1) Direct Investment
- National treatment and most-favored-nation treatment
- Fair and equitable treatment
- Dispute settlement procedures
- There is no investment agreement in WTO and, generally, investment provisions in FTA contribute to promotion of FDI in world trade.
- There are many BITs which provide for similar rules.

(2) Competition policy

- Competition policy and trade
- Bilateral competition policy agreement
- Many FTA contain competition policy provisions.
- Types of competition provisions in FTA – NAFTA type and EC type
- Each party deals with competition issues by its national laws.
- Competition provisions in Japan/Singapore Agreement
- There is no competition agreement in WTO and, in this area, FTA contributes something toward liberalizing world trade.

(3) Trade Remedies

- Complicated relationship between trade remedies within FTA and the WTO rules
- Parallelism approach
- Substantially all approach
- WTO plus in AD provisions in FTA
- Abolition of trade remedies within FTA – Australia-New Zealand Agreement
- Discriminatory aspects of trade remedy provisions in FTA

(4) Dispute Settlement

- Dispute settlement procedures in BIT – Investor v. State
- Dispute settlement procedures in FTA – State v. State
- Dispute settlement at WTO – State v. State
- Referral to arbitral panel
- Remedy
- Three types of dispute settlement system
- What is the relationship between dispute settlement procedures in the WTO and those in FTA?
- Need for stocktaking and harmonization and convergence of procedures and substantive rules

(5) Origin Rules

- There is no effective origin rules in WTO.
- Great diversity of origin rules in FTAs such as substantial transformation rule, added value rule and tariff classification rule etc.
- Certification of origins – Here also there is diversity among FTAs such as government certification, self-certification etc.
- Parallel existence of divergent origin rules between FTAs may create confusion and cause higher transaction costs to multinational enterprises.

(6) Movement of People

- No uniform rules in GATS
- There is variety in FTA provisions on this issue.
- In Japan/Mexico FTA, short term business stay for business persons, long term stay for investors and experts and, in Japan/Philippines FTA, stay of nurses and welfare experts
- In future, introduction of simple labor will be a great issue.

(7) Intellectual Properties

- Basic rules are provided in TRIP including Paris Convention and Bern Convention.
- Some additional rules are provided in FTA.
- In Japan/Singapore FTA, there are provisions for facilitating grant of patents and exchange of information regarding IP rights.
- In Japan/Mexico FTA, there is provision for geographic indication of distilled liquor.
- In Japan/Malaysia FTA and Japan/Philippine FTA, there are provisions for simplifying and expediting procedures for granting patents, trademarks.

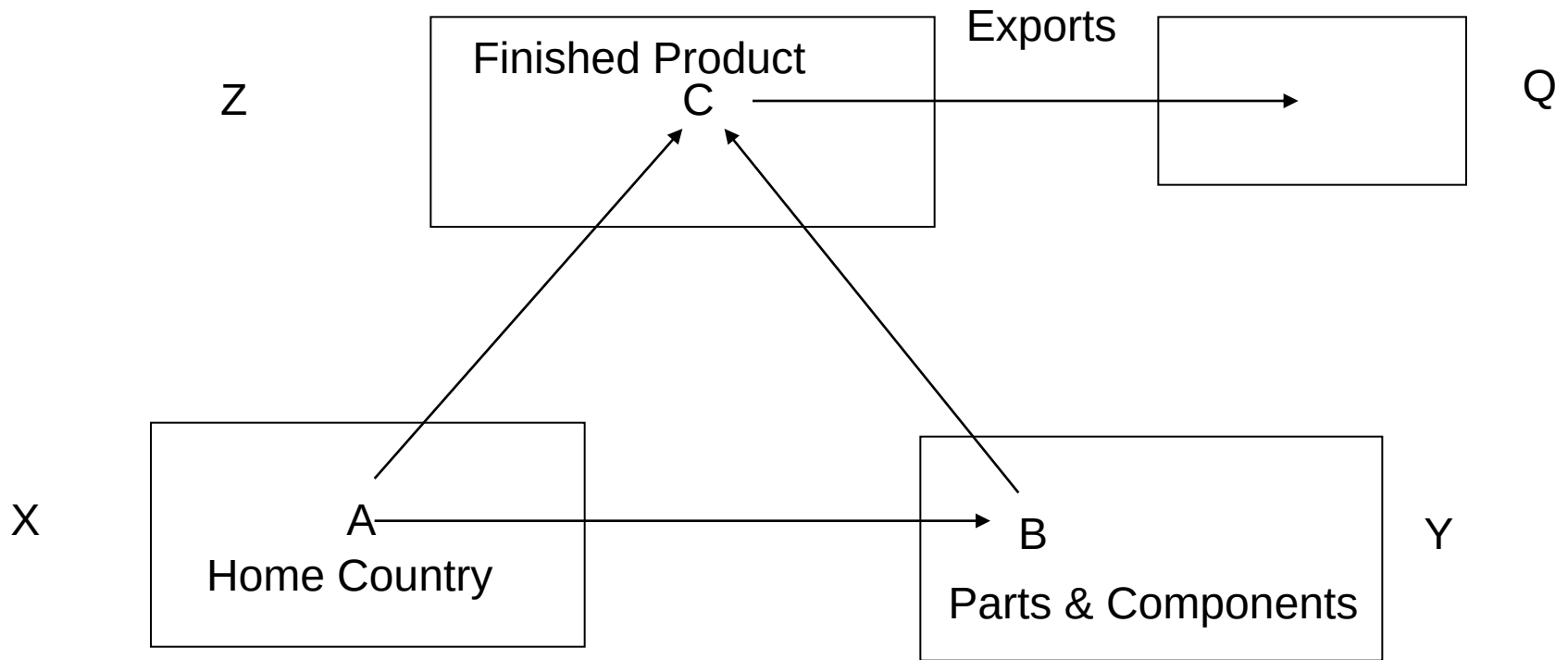
(8) Environmental Protection

- There are provisions on environmental protection in many FTA agreements.
- If environmental protection is lax in a party, this gives undue advantage to industries in the territory of that party.
- In some FTA agreements, there are provisions which state that each party does not solicit FDI by lax environmental protection.
(Japan/Malaysia FTA and Japan/Philippine FTA)
- In some cases, mutual recognition of environmental protection among the parties is provided for.

4. Harmonizing FTA Rules

- Multinational corporations shifting sites of production, especially to developing countries.
- Labor costs, lax environmental protection and securing of natural resources.
- Japanese direct investment: In 1999, the share of East Asia was 7% of the total outgoing investment but it increased to 40% in 2004 and still increasing.
- In 1990, Japanese export to East Asia occupied 39% of the total export and it increased to 51% in 2004 and it is increasing rapidly.
- In globalizing operations of enterprises, harmonization of FTA rules are more and more important.

Multilateral Production System



Possibilities for FTA

- X-Y, X-Z, X-Q ,Y-X, Y-Z, Y-Q, Z-X, Z-Y, Z-Q
- All of them may have different rules on trade such as origin, environment, intellectual property, competition, trade remedies and so on.
- Differences of rules of trade between FTAs create complexity and confusion and sometime lead to increase of transaction costs.
- Such differences create unequal conditions for industries located in areas covered by different FTAs.
- This may lead to trade disputes for the lack of level-playing field.

Should There Not Be FTA Network?

- Instead of imposing a set of uniform rules, an establishment of forum of exchange of information and cooperation (network) is more practical.
- Who will do it? WTO, APEC, ASESAN?
- If RTA is established which covers a wide areas and countries, this may be an appropriate forum.
- WTO can utilize TPRM and monitor FTA rules.
- Through this mechanism, WTO can advise countries which are members of FTAs to contact each other, engage in talks and try to make convergence of FTA rules.

5. FTA and Developing Countries

(1) Direct Investment

- Advantages→ Introduce direct investment , technology and managerial resources from developed countries. Also access to markets of developed countries.
- Disadvantages→ Developing countries are better off in multilateral negotiations rather than bilateral negotiations because, in multilateral negotiations, they can use collective power in relation to developed countries.

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- Developing countries probably prefer positive list liberalization formula rather than negative list formula
- Greenfield investment is probably preferred by developing countries.
- Safeguards and safety net are necessary especially in the areas of basic social infrastructure (telecom, water system etc)
- How to resolve disputes in such areas will be a big problem in future-not only entry issues but also exit issues will be important.

(2) Competition Policy

- Control of abuse of dominant positions on the part of MNC and exploitation of local firms should be dealt with→ protection of subcontractors, dealers and distributors.
- Exchange of information between developed and developing countries with regard to enforcement of competition laws.
- Article 40 of the TRIPS Agreement should be used.
- Relationship between industrial policies and competition policy should be explored.

(3) Environmental Policy

- Current FTAs provide that the parties should not use lax environmental policy to solicit direct investment.
- However, this alone should not be sufficient. There should be a program to promote transfer of technology and investment into developing countries.

5. Role of FTA in International Environmental Policy

- Multilateral approach – Kyoto Protocol
- The Cop 15 Accord (2009)
- There will be a limit to multilateral formula in which an international organization imposes quota on GHG emission. (U.S. and China)
- In future, there will be diversified approach in international environmental policy.

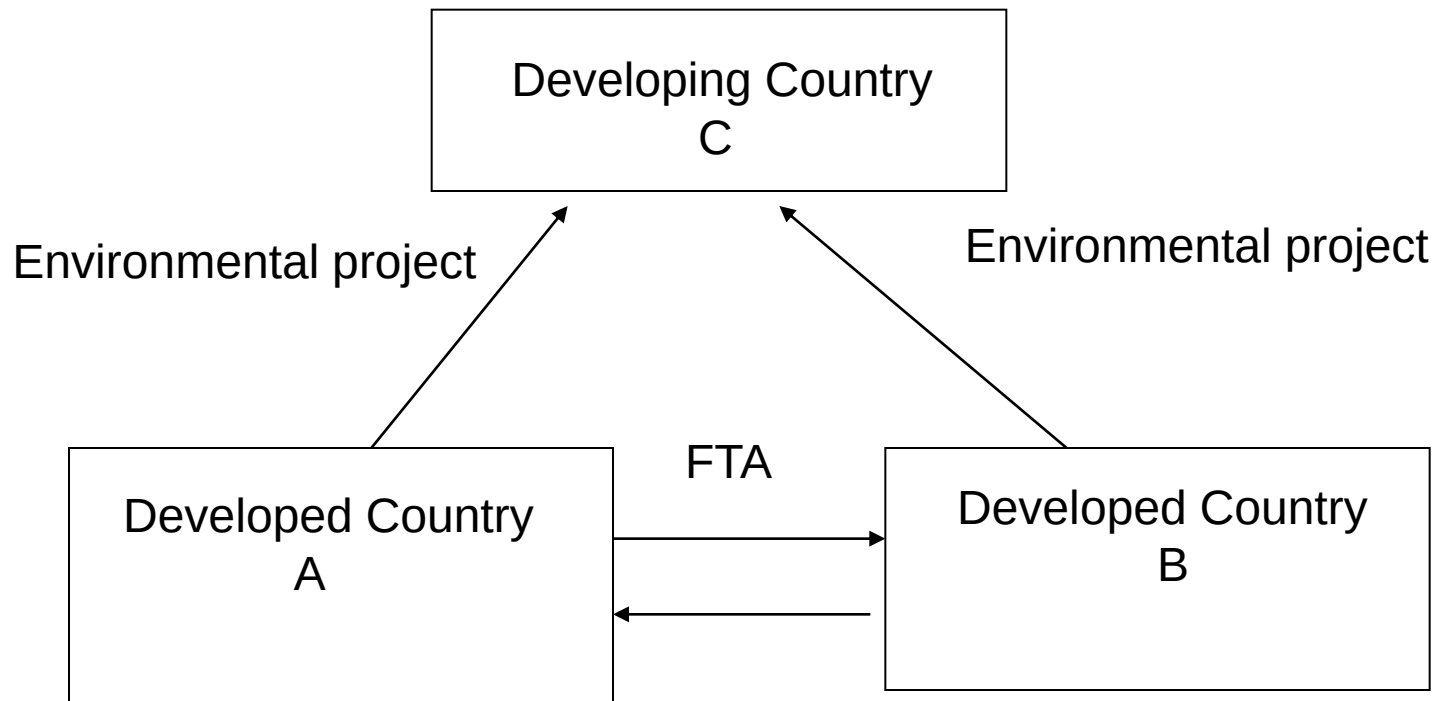
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- Country A and Country B enter into bilateral agreement and mutual recognition of credit in reducing GHG.
- Credit gained by enterprise in A can be sold to enterprise in B and vice versa.
- Enterprises in A and B engage in a joint program to reduce GHG in C. Credit can be sold to the governments of A and/or B or to other enterprises in both countries.

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- The governments of A and B provide environment subsidy to such joint operations. (SCM issues may arise.)
- Alternatively the governments of A and B provide environment subsidy to the government of C with the condition that this subsidy can be used only to finance environmental projects. (Type of ODA)

Illustration



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- Such environmental programs can be included in FTA arrangements. This may be a good idea because environmental program is closely related to direct investment, transfer of technology , intellectual properties and development policy all of which are important subjects of FTAs.
- In Kyoto Protocol, UN is the only entity to authorize projects for CDM.

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- In future, a combination of diversified scheme and multilateral scheme will be important.
- For example, UN authorizes projects sponsored by nations using FTAs and then credit can be sold universally.