

# Growing FTAs & Their Impact on World Trade

By *Urata Shujiro*

## FTAs Rising Fast in the World

Bilateral or regional free trade agreements (FTAs) aimed at liberalizing trade with particular countries have been increasing quickly in the world in recent years. The first-ever FTA was notified to the General Agreement on Tariffs and Trade (GATT) in 1958 and the number of FTAs was 25 at the end of 1990. Many more FTAs were concluded in the 1990s, and the number of FTAs notified to GATT and the World Trade Organization (WTO), which replaced GATT in 1995, reached 91 at the end of 2000. Later, FTA notifications increased at an even faster pace. As of March 2007, 194 FTAs existed in the world. Until the 1990s, FTAs increased quickly in Europe and the Americas. Since 2000, Japan and other East Asian countries have been rapidly expanding FTAs to catch up with other regions.

## Factors Behind Fast FTA Growth

There are various factors behind the fast rise in the number of FTAs in the world. One major factor to be singled out first is a stalemate in GATT/WTO multilateral trade negotiations. The Uruguay Round of negotiations, which was the last round under GATT, started in 1986 and had rough going. It took eight years before producing a final agreement in 1994. While multilateral trade negotiations were stalled, countries interested in trade liberalization negotiated and concluded bilateral or regional FTAs to promote liberalization. Behind the rapid increase in the number of FTAs after the WTO's inauguration has been a stalemate in the Doha Round of trade liberalization talks, the first round under the WTO.

A second factor is the effect of FTAs inducing other countries to negotiate FTAs of their own. If some countries

conclude FTAs, others seek to do so in an effort to secure export markets. Such stimulative effects have led to the fast rise in the number of FTAs. Specifically, the 1992 European market integration prompted the United States, Canada and Mexico to produce their North American Free Trade Agreement (NAFTA) in 1994. In East Asia, Japan's growing interest in FTAs has stimulated China's interest in FTAs. In turn, China's aggressive FTA strategy has stimulated Japan's FTA strategy.

A third factor is a growing interest in making rules for economic spheres where the WTO has yet to lay down rules. A specific example is liberalization of direct investment. WTO rules cover only trade-related investment measures (TRIMs). Countries interested in liberalization and facilitation of investment have begun to use FTAs as a framework for making rules covering broader areas of investment. FTAs have recently grown more comprehensive, covering not only trade liberalization but also investment liberalization, protection of intellectual property rights and human movements. The Japanese government views economic cooperation as a key part of an FTA and positions an FTA as a comprehensive arrangement for building closer economic relations. In this sense, it names such arrangements as economic partnership agreements (EPAs).

A fourth factor is promotion of structural reform within each country. In recent years, structural reform has been appreciated as important for economic growth, but there is strong resistance from people who are affected by reform. Some governments now exploit FTAs as foreign pressure for forcing domestic structural reform. This has also helped increase FTAs.

A fifth factor is that countries have begun to take advantage of FTAs for increasing their influence on international markets and relations. Countries

Photo: Kyodo News



(From left to right) South Korean President Roh Moo Hyun, Chinese Premier Wen Jiabao, Philippine President Gloria Macapagal Arroyo, Japanese Prime Minister Abe Shinzo and Singapore Prime Minister Lee Hsien Loong wave before the ASEAN-plus-three meeting on the Philippine island of Cebu on Jan. 14.

Photo: Kyodo News

that have small influence seek to increase their influence by promoting mutual cooperation under FTAs. For example, members of the Association of Southeast Asian Nations (ASEAN) have created the ASEAN Free Trade Area (AFTA) to counter the growing presence of China.

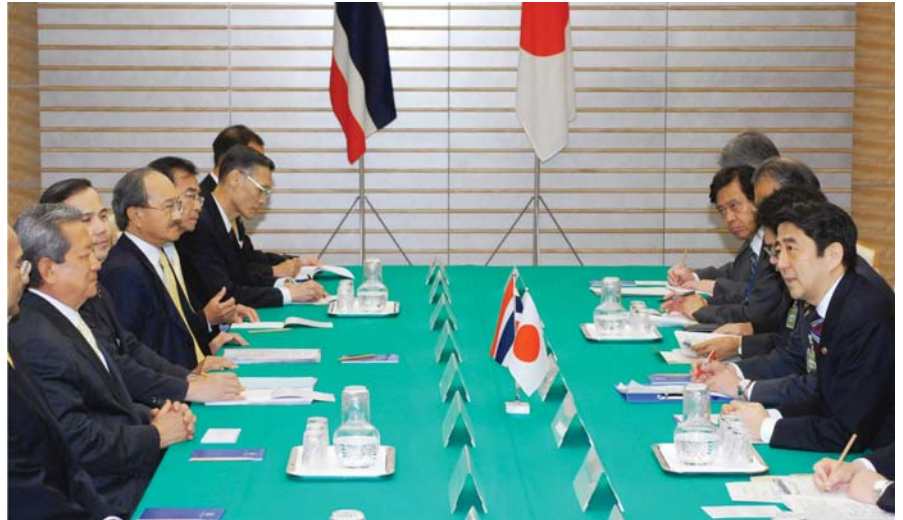
Lastly, East Asian countries have grown more interested in regional cooperation since the 1997-98 economic crisis, contributing to the increased FTAs. Crisis-affected East Asian countries failed to receive as much support as they expected from others. They then have promoted regional cooperation to help avoid crises, agreeing to use FTAs effective for expanding trade and investment as part of such cooperation.

### FTAs & WTO Negotiations

FTAs are supposed to promote economic growth through expansion of trade and investment. But some skeptics are concerned that FTAs could curb global trade and adversely affect global economic growth. As this point is very significant, I would like to look into the impact of FTAs/EPAs on world trade.

FTAs may work to reduce FTA member countries' trade and investment with nonmember countries, indicating that FTAs could have adverse effects on the world economy. In fact, between the first and second World Wars, many countries sought to shield their economies from other recession-hit countries by adopting FTA-like policies – favoring their colonies and certain foreign countries in trade while setting up trade barriers against others. Such trade policies brought about contraction of global trade and eventually the Great Depression. Serious economic difficulties caused by the Great Depression are said by some to have prompted great powers to invade other countries for market expansion, triggering World War II.

Some people liken the recent rapid increase in the number of FTAs to the situation between the two wars. This skeptical view is not reasonable because GATT, which was created after World War II, introduced a mechanism to prevent FTAs from becoming exclusive in view of lessons learned from the past. Specifically, any country creating an



Prime Minister Abe Shinzo (extreme right) holds talks with his Thai counterpart Surayud Chulanont (left) at his office in Tokyo on April 3.

FTA with a foreign nation is prohibited from raising trade barriers against other countries. Under GATT, any FTA is required to effectively cover all products, raising the possibility that economic growth through expansion of trade between FTA member countries could work to expand their trade with others.

Another skeptic opinion says a lack of unified country-of-origin definitions between FTAs could work to curb global trade. Since FTAs liberalize imports of goods produced in FTA member countries, beneficiaries from import liberalization must obtain country-of-origin certificates that identify specific products as manufactured in these countries. Existing FTAs adopt different country-of-origin definitions, forcing traders to obtain different certificates from many FTA member countries. Skeptics say such costly procedures are expected to discourage traders from expanding imports, possibly curbing world trade. This may amount to the so-called “spaghetti bowl effect” emerging from an increase in FTAs. People against such a skeptical view note that only the costs to benefit from FTAs would increase. Unless traders try to benefit from an FTA, the situation after the FTA creation remains unchanged from before the creation, they say, concluding that trade will not decline. This conclusion may be reasonable. But it is important to lay down convenient coun-

try-of-origin rules to maximize advantages of FTAs.

Bilateral or regional FTAs can be expected to contribute to global trade expansion by promoting WTO trade liberalization talks. For example, an increase in the number of FTAs may prompt some countries to appreciate the importance of WTO talks and promote them in a bid to avoid the disadvantage of being excluded from FTAs or otherwise isolated. Some people say invigoration of moves toward European and North American FTAs played a key role in bringing the Uruguay Round to a conclusion. Others say trade liberalization under FTAs may work to reduce resistance to liberalization in uncompetitive areas and make it easier to promote liberalization through WTO talks.

Recent FTAs/EPAs cover not only trade liberalization but also other matters and are expected to contribute to expansion of global trade by complementing the WTO and promoting closer relations between national economies. In order to allow FTAs and the WTO to complement each other, WTO member countries should create comprehensive FTAs for greater trade liberalization at the same time as proceeding with WTO trade liberalization talks. **JS**

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