

**Conclusion**

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## Conclusion

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Why have so many countries pursued free trade agreements (FTAs) in recent years even though most of them consider multilateral liberalization may be the best way to maximize individual, as well as global, welfare? This is the main question that this book tries to answer.

Theoretical and institutional explanations are offered in Part I. From the point of view of economic theory, Chapter 2 explained that, in addition to the traditional revenue transfer effect that FTAs can generate for their parties through trade diversion, additional incentives in the form of envisioned dynamic effects encourage countries to form FTAs. These additional incentives include the realization of economies of scale, efficiency gains from increased competition, technology diffusion and the enhancement of investment flows. It also pointed out that FTAs have the potential to improve their parties' terms of trade with respect to outsiders. In the anarchical international system, countries have incentives to use FTAs strategically to realize better terms of trade.

The examination of the development of the concepts and practice of "most favored nation" (MFN) treatment and "reciprocity", and how they were incorporated into the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO) in Chapter 3 indicated that the GATT/WTO multilateral trade system, from its inception, contained a difficult question of keeping balance between its prime principles—non-discrimination and reciprocity—in its actual operations. Subsequently, package (rounds of multilateral trade negotiations) and optional "code" approaches were introduced for the purpose of ensuring better enforcement of reciprocal liberalization, but they did not solve the question completely. Moreover, the weak nature of the GATT as an international organization,

unlike the International Monetary Fund (IMF) and the World Bank, did not help it assert strong authority over its members. Most of these problems have been inherited by the WTO. In the recent context, the “UNization” (Chapter 3) of the WTO, mainly due to the increasing number of its members, has been leading to the malfunctioning of multilateral trade negotiations. In addition, the relatively strengthened “rule of law” following the establishment of the WTO regarding the monitoring of the international trade has been encouraging countries to avoid “gray” practices, such as the code approach, and opt for FTAs that are accepted by Article XXIV to assure reciprocal liberalization.

Economic analyses imply that, under the assumption of “rational” behavior, an incentive to form FTAs almost always exists for countries, irrespective of progress on multilateral and regional liberalization, to maximize their individual economic welfare. Worse still for multilateralists, the recent “gridlock” (Chapter 3) of the WTO in conducting multilateral liberalization further motivates pro-liberalization countries to run faster than others by forming FTAs with like-minded partners. It also suggests that countries have become more sensitive to the need for reciprocity in their trade liberalization. As Chapter 3 pointed out, it is easier to secure “specific” reciprocity in FTAs than in the WTO, which allows “diffuse” reciprocity. These calculations must have contributed to FTA proliferation in recent years. However, as indicated in Chapter 1, the incentives for individual countries to form FTAs seem to be more diverse in reality.

As the concluding part of this book, this chapter, first, will highlight the diversity of these concrete motives (objectives, factors) by summarizing the case studies conducted in Part II. In doing so, it will consider how best the results of the case studies can be understood through the three frameworks of international political economy (IPE), presented in Chapter 4. This is important, as it will influence the second task of this chapter: further discussing the issue of FTA multilateralization.

### **Diversified but Interrelated Objectives for FTAs**

As expected, the case studies illustrated that there are multiple objectives (motives, incentives) for FTA formation. Chapter 1 divided the motives outlined in theories and experiences into two general categories—“economic” and “political”—for the purpose of making the discussion clear. However, the results of the case studies show that it is impossible to clearly separate economic objectives from political ones, as almost every economic incentive

has a political background. One of the reasons for this phenomenon must be that, as mentioned earlier, countries do not only aim for direct revenue transfer effects through trade diversion but also dynamic effects that would have broader impacts on domestic economies as well as regional and international trade structures. Dynamic effects, more likely than not, would have stronger impacts on FTA parties and take a longer time to actualize than static ones. Thus, countries seem to see the need to take a variety of domestic and international concerns into account to justify their FTAs.

### ***To Gain Economic Benefits from Trade Diversion***

As indicated by a number of economic theories, achieving economic benefits from improved market access and an improved investment environment are found by most of the case studies to be the basic motivators for FTA formation, though the levels of importance of these factors seem to vary case by case. The will of most countries to make their FTAs as comprehensive as possible by covering "WTO plus" elements illustrates more emphasis on the economic gains from the dynamic effects of FTAs. Stagnation of multilateral and regional liberalization processes, such as the GATT/WTO, APEC and the ASEAN Free Trade Area (AFTA), is listed as a trigger for their rapid moves towards FTAs.

The basic driving force of US "regionalism" in the late 1980s and early 1990s was the need to support domestic businesses when the Uruguay Round seemed to have stalled. Its efforts culminated in the North American Free Trade Agreement (NAFTA). NAFTA was to assure more market access to neighboring markets—Canada and Mexico—and to secure the utilization of cheap and abundant labor in the latter country for US industries. In addition, comprehensive coverage of "WTO plus" areas, in particular intellectual property rights protection, was important for the United States as they were perceived to be the keys for the development of emerging industries such as information and communications technology. The Uruguay Round agenda included these areas, but for the US administration and business, it was too slow to realize them. That the United States intended to achieve relative economic gains through NAFTA became clear when Mexico signed an FTA with the European Union (EU) in 2000. Though Mexico granted the same, not better, preferences to the EU as it did to the United States under NAFTA, the United States (and Canada) demanded the acceleration of the NAFTA tariff reduction schedule (Chapter 6). For Mexico, on the other hand, its economic relations with the United States were already the most important, but it needed to secure even more market

access to and investment flow from the United States. They were needed for the purpose of stabilizing its drastic economic reform policies undertaken since the 1980s, which will be touched upon later.

Shortly after the establishment of NAFTA, the United States moved to extend the geographical area in which the NAFTA provisions applied to cover whole Latin America and the Caribbean through the Free Trade Area of the Americas (FTAA) initiative. The Americas, as a whole, was where the pace of growth of US exports has been fastest in the 1990s (Chapter 5). This trade strategy of the United States fitted with that of Chile well. Chile needed to secure the growth of its exports in tandem with the unilateral liberalization efforts it had undertaken since the 1970s. It turned to bilateral agreements for the realization of this objective beginning in the early 1990s, first with neighboring countries in Latin America, but by the end the decade, increasingly with extra-regional partners such as Canada, the EU and the United States, and even with countries across the Pacific like Australia, New Zealand, Japan, Korea and Singapore. In this context, the Chilean government's aspiration to conclude FTAs to cover 90 per cent of its trade volume by 2010 (Chapter 7) can be seen as a strategy to assure (relative) economic gains quickly via reciprocal liberalization before they disappear when the multilateral liberalization process proceeds. For Chile, the US initiative for the FTAA provided a convenient vehicle to move its trade strategy forward.

New Zealand had a similar policy background to Chile. It had already reduced trade barriers significantly and unilaterally beginning in the 1980s. The most important trade policy issue for New Zealand was—and still is—multilateral liberalization of agricultural trade so that it could increase the export of its most competitive products. When the Uruguay Round, which included agriculture for the first time in the GATT's history, deadlocked, the government declared in 1993 that it would pursue every possible trade strategy (unilateral, multilateral, regional and bilateral) to realize its objective. As all other measures turned out to be unsatisfactory, and being a small country that could not influence the direction of multilateral negotiations, New Zealand opted for forming FTAs. Trying to emulate the success of the FTA with Australia (Australia New Zealand Closer Economic Relations Trade Agreement, CER, entered into force in 1983), the New Zealand government explored the possibilities of several FTAs, including those with Chile, Singapore and the United States, and a plurilateral FTA called the Pacific Five (Australia, Chile, New Zealand, Singapore and the United States). By the end of 1990s, however, it became clear that an FTA with Singapore was the only viable option, thus the government decided to

start negotiations with this country. As Singapore was already a virtual free trade state, the New Zealand government considered an FTA with it would not bring about a significant increase in agricultural exports. Rather, New Zealand's decision had a "strategic" aim to stimulate multilateral liberalization through its bilateral initiatives (Chapter 12).

As a small, developed country that had implemented a unilateral liberalization policy since the 1980s, the circumstances that Australia faced were almost the same as New Zealand's. However, there were differences in when and how these two countries adopted FTA policies. Australia did not adopt FTAs as a trade policy option until 1997, well after the completion of the Uruguay Round, and after that, it took more than three years to commence concrete negotiations with Singapore. This time lag was caused by the government's persisting expectations of further development of multilateral (the WTO) and regional (APEC and the AFTA-CER FTA) liberalization, which were supported by relatively good export performances of the economy during the late 1990s. When all these expectations had disappeared, at least for a time, by mid 2000, Australia turned to bilateral FTAs. As its move towards bilateral FTAs was perceived "belated," the government's initial objective was to assure "equal treatment" of its products and firms to those of its competitors in its major export markets such as Japan, the United States, Korea and ASEAN countries. The government's and businesses' open assertion that "Australia was ready to compete on level playing field" was unique. However, after the completion of the FTA negotiations with Singapore, a country that does not offer significant economic benefits unlike others such as China, Japan and the United States for similar reasons to the case of New Zealand, Australia seems to be increasingly inclining towards gaining better treatment earlier than others through its FTAs in the name of "competitive liberalization," which will be discussed later.

The case study of Thailand also demonstrated its frustration with multilateral and regional liberalization processes. The efforts of Thailand to realize AFTA more quickly after the Asian financial crisis in 1997 did not pay off because of virtual opposition from other members, especially Indonesia and Malaysia. Therefore, Thailand's intention to base economic recovery primarily on ASEAN cooperation was abandoned, at least as its highest policy priority. After the failure of the WTO Seattle Ministerial Conference in late 1999 to launch a new round of multilateral trade negotiations, the Thai government started to consider bilateral FTAs seriously. By 2000, the government had approached countries like Chile, Croatia, Czech and Korea, with all of which, except for Korea, Thailand did

not have very significant trade relations, for talks on bilateral FTAs. When power transferred to the Thaksin government in early 2001, however, the pursuit of economic gains through FTAs became more aggressive. The government has approached major trade partners and potentially big markets for its exports. During the period of just one year, it proposed bilateral FTAs to Australia, India, the United States, Japan and China in this order.<sup>1</sup>

Though it is also an important member of ASEAN, Malaysia's stance on FTAs in general is quite contrary to that of Thailand. Because of the economic and trade structure that has developed over the last two decades, Malaysia does not see significant economic benefits in bilateral FTAs. Its main exports now are manufacturers, especially in electrics and electronics, and the major destinations are developed countries such as the United States and Japan, where trade barriers for these products are already low. Traditional exports of primary products like crude petroleum and palm oil have become less important for its economy. On the other hand, FTAs had a potential to undermine its domestic industry policy to protect and develop some sectors, in particular automobiles. In this sense, Malaysia preferred the multilateral (the GATT/WTO) liberalization process, under which developing countries could claim "special and differential" treatment more favorable than developed countries, to FTAs that would force liberalization of all trade under the GATT's Article XXIV. Malaysia's commitment to AFTA was possible because it was a regional cooperation scheme of ASEAN on which the Malaysian government placed the highest foreign policy priority. When the AFTA tariff reduction process started in 1993, Malaysia had an optimistic outlook that its protected industries would develop and acquire enough competitiveness by the time regional free trade was realized in fifteen years as originally scheduled. Moreover, even if they would not be as competitive as hoped by then, the government believed that it could change its commitments and delay the liberalization schedule, which it actually did after the outbreak of Asian financial crisis in 1997, since AFTA was a flexible cooperation scheme under the ASEAN framework.

In Chapter 8, gaining economic benefits through trade diversion seemed not very important, at least officially, as an objective of Japan's FTA initiatives at the initial stage. Direct economic incentives were presented rather defensively only in the case of an FTA with Mexico. As Mexico had already established NAFTA and the FTA with the EU, Japanese firms operating in Mexico had to compete under disadvantageous conditions with North American and European firms. The government needed to remove these disadvantages in Mexico by negotiating and concluding an FTA. Chapter 8, however, pointed out after close chronological analysis that even

this objective of an FTA with Mexico appeared to be a kind of "afterthought." Japan's FTA initiatives have other objectives than direct economic gains that have evolved with changes in the regional and international environments, especially after the Asian financial crisis of 1997.

### ***To Support Domestic Economic Reforms***

Over the last two decades, countries like Australia, Chile, Mexico and New Zealand have conducted comprehensive economic reforms that aimed at transforming their domestic economies from protected and inward-looking ones to open, market responsive ones with more export diversity both in terms of products and destinations. Naturally, they all needed an international economic environment that assured freer movement of goods, services and capital. From the case studies of these countries, it can be seen that Australia and New Zealand have been trying to use FTAs, under the environment of retarded multilateral and regional liberalization processes, to "underpin" their domestic economies that have already been comprehensively reformed, while Chile seems to have always had FTAs as a policy option to realize the same aim. Meanwhile, Mexico has used NAFTA more as a commitment mechanism for "locking-in" its reforms.

The Mexican government started a restructuring of its trade and investment regime in the 1980s and NAFTA was considered a key mechanism to seal the economic reforms. As the United States was its most important economic partner by far, it was necessary for the Mexican government to secure US commitment to its reforms. The government expected to stabilize its reform policies to the extent that they cannot be turned back, if closer linkages with the US market and investment were established by significantly opening up its economy to the United States. From the US point of view, too, NAFTA was expected to work as a stabilizer for its southern neighbor's politics and economy, and reduce the rapid inflow of illegal migration from Mexico across the border.

The result of NAFTA for Mexico was the greater reliance of its economy, which was already dependent on the US economy, on the United States. While the trade volume between Mexico and the United States has increased after NAFTA and Mexico's exports shifted from traditional oil products to manufactures, Mexico's national firms, especially small and medium-sized enterprises, suffered because of the collapse of the domestic production chains. Mexico's economy has become more vulnerable to US recessions, such as that experienced at the beginning of this decade (Chapter 6). In addition, because the Mexican economy's reliance on the United States is so

great, Mexico's FTAs with other countries will not be capable of diversifying its trade partners. Thus, there have emerged some concerns and critiques that Mexico's FTA initiatives may be just aiming for dodging domestic criticisms of its excessive dependence on the United States.

Japan argued during the process of FTA negotiations with Singapore that the FTA would be a catalyst for domestic structural reforms. Expecting FTAs to be "catalysts" for domestic economic reforms is not exactly the same as using them as commitment mechanisms. As discussed in Chapters 1 and 8, the FTA with the free trading city-state, which virtually did not touch upon the agricultural sector, may well be too weak to be recognized as a commitment mechanism. On the other hand, the "catalyst" effects of the FTA remain to be seen, but it is often argued that reform policies should be propelled by domestic initiatives rather than by agreements with foreign countries. Also, if Japan continued to seek FTAs with developing countries as it does now and to leave agriculture out of its FTAs, the catalyst effects may be much less than it expects.

The Thai government also discusses its FTA initiatives in the context of linkages with its domestic economic reforms. The government emphasizes the so-called "dual track" policy that pursues, on the one hand, export growth and foreign direct investment inflow through AFTA and bilateral FTAs, and on the other, the strengthening of the domestic economy through government involvement in financial and production activities. As Chapter 9 pointed out, how the policies for these two goals enhance each other is not self-evident. The dual track policy is more likely to become unsustainable gradually because the former requests the elimination of government control of the domestic economy, but the latter inevitably entails government interventions.

### ***To Gain Influence over Regional and Multilateral Trade Liberalization***

FTAs are employed as tools to influence multilateral and regional trade politics. Most countries aim to lead the multilateral and regional liberalization agendas in directions favorable to them.

At the same time as strongly supporting its domestic businesses and setting regional rules on WTO plus areas through NAFTA, Chapter 5 explained that the United States used it for the purpose of stimulating multilateral trade liberalization. The US administration's message through NAFTA, in this context, was that it would go its own way with regional trade agreements if the Uruguay Round did not deliver what it wanted. In

fact, the United States' seeking to influence the multilateral trade system through its FTAs has continued after the completion of the Uruguay Round. As mentioned earlier, one of the objectives for the United States in establishing the FTAA is to broaden the geographical area in which new trade-related rules incorporated in NAFTA provisions are applied. By doing so, the United States expects the "NAFTA standard" to become the "Americas standard," in addition to achieving the economic gains that increased access to the Americas would bring. From the US point of view, the FTAA would significantly reduce transaction costs by integrating all existing FTAs in the region. The recently concluded FTA negotiations with Chile are perceived to be a stepping stone to the FTAA. The United States' ultimate goal is to globalize the NAFTA standard. The FTAA, then, is expected to give considerable bargaining power to an already powerful negotiator, the United States, in the multilateral liberalization process.

The US administration considers its bilateralism and regionalism are complementary, not alternatives, to multilateralism. Policy makers believe that the multilateral trade regime will be strengthened if the United States advances its bilateral and regional FTA initiatives first, and then the contents of these FTAs are globalized through the WTO. This "linear" thinking of US trade policy is the logic of a hegemon. Similarly, the recently articulated concept of "competition in liberalization" or "competitive liberalization," which encompasses an expectation that US bilateral and regional initiatives would put pressure on third countries to liberalize out of fear of being left out and discriminated against, is also the logic of a hegemon. While the United States seems to believe in these logics, its aggressive policy behavior in support of them has already been criticized and induced resentment in many Latin American countries (Chapter 5). In reality, the stages of economic development, the political climates as well as the social and cultural values of the thirty-four potential members of the FTAA are diverse enough to preclude uniform agreement with the US idea. Their preferences for the rules on WTO plus areas are also diverse, and building a consensus on how to deal with a number of existing bilateral and regional trade agreements is never easy. In addition, it is also pointed out in Chapter 5 that domestic opposition to "free(r) trade" and "globalization" from environmental groups, labor unions and others, which consider NAFTA to have failed to meet their demands, has grown to the extent that it will have considerable impact on US trade policy making.

Australia expected its FTA with Singapore to have "demonstration effects" on other ASEAN members because, though it still preferred a regional FTA, the AFTA-CER FTA plan had been shelved. However, how

much impact an FTA with a city-state recognized as one of the most open economies in the world would have on other ASEAN members was uncertain at best from the start. If the ongoing FTA negotiations with Thailand, which were proposed by Australia and not the other way around, are successfully concluded and the FTA shows concrete and significant economic benefits, it may stand a better chance of having demonstration effects. Meanwhile, Australia's originally defensive approach to FTAs seems to be changing after the completion of the FTA with Singapore. The government now asserts that it aims for competitive liberalization *a la* United States through its FTAs and indicated several potential partners. It seems that the government considers that it can influence multilateral liberalization through its FTAs, but being a small country, not even a regional hegemon, whether Australia's FTAs would put pressure on other countries to liberalize is, again, questionable. Likewise, the viability of the New Zealand government's "strategic" aim to stimulate multilateral liberalization, especially in agriculture, through its FTAs is questionable. After the completion of the FTA with Singapore, New Zealand has moved on to negotiate an FTA with Hong Kong, another free trading city economy. An FTA with Hong Kong can be seen as a continuation of the New Zealand government's strategy, but its effect on multilateral trade liberalization in agriculture, despite the government's intentions, would be as limited as that of the New Zealand-Singapore FTA.

Japan's main motivation behind its recent FTA initiatives seems to be gaining influence on the multilateral liberalization process. In the government's official documents, these objectives were described as "the development of new trade rules" and "the accumulation of international system building experience." By negotiating FTAs, Japan can accumulate knowledge of the contentious issues of trade politics, negotiation tactics and coalition building. The experiences acquired can be utilized during the multilateral negotiation process. For a country that did not have FTAs before, this objective seems important. To put it simply, Japan aims for a better negotiation position in the WTO process by building a coalition of its "comprehensive economic partnership" initiatives that include FTAs, with its partners assumed to be the "East Asian" countries consisting of the ASEAN members, China and Korea as well as Australia and New Zealand. It can also be seen as a new manifestation of Japan's trade policy that intends to play a leadership role in creating "East Asian" standard rules, which are not necessarily the same as, or similar to, "North American" and "European" standards.

### ***To Enhance Security and Management of Regions***

The United States has experiences in using FTAs mainly for political/strategic purposes. Its FTAs with Israel (1985) and Jordan (2001) can be seen as symbols of its political inclinations and security strategies, rather than seeking particular economic benefits. The FTAA initiative is also a part of its broader political and security projects, on top of economic gains that the FTAA is expected to generate. The US administration expects the FTAA to help stabilize the politics of countries in Latin America and the Caribbean through steady economic development, which will bring greater security to the Americas. Also, the United States is insisting on the inclusion of provisions for broader security and management of the region in the FTAA, such as the protection of labor rights and the environment, democratization and the prohibition of trade of illegal drugs.

The terrorist attacks on September 11, 2001 seem to have bolstered the US intention to strategically use its FTAs for the purpose of strengthening security. Since the enemy in the war against terrorism is not a nation state, the US administration sees its (and other countries') security can be enhanced through advancing prosperity and freedom in the world, even more so than occurred during the Cold War period. The US administration seems to believe that its FTAs will help this cause (Chapter 5) and FTAs with extra-regional countries have re-emerged. The recent bilateral initiatives of the US administration directed towards geopolitically important countries in Northern and Southern Africa, the Middle East and ASEAN are in line with this strategy. No other countries in the case studies, except for Australia in the case of an FTA with the United States, explicitly raised security as a major objective of their FTA initiatives. Nevertheless, as US unilateralism grows, as seen in its preparation for the war on Iraq in late 2002 and early 2003, the number of FTA initiatives it launches in support of its security objectives can be expected to increase.

### ***To Expand Regions for Building Wider Communities***

A notable phenomenon that has arisen since the latter half of 1990s is the expansion of the traditional concept of a region. This has occurred in parallel with countries' intentions to achieve economic benefits from, to gain influence on multilateral liberalization process through, and to strengthen their security through FTAs. The proliferation of FTAs and expansion of regions are interactive events that appear to enhance each other. As the eastward expansion of the EU is changing the concept of the "European"

region, the FTAA initiative seems to be building a new regional concept of "the Americas." The United States even asserts that it sees the convergence of values among countries in North America, Latin America and the Caribbean, which, if true, will be the cornerstone of a developing Western hemispheric community.

At the other side of the Pacific, a new regional concept of "East Asia" that connotes both Northeast and Southeast Asia has emerged and is expected to converge with the ASEAN+3 (China, Japan and Korea) framework. Japan had always felt isolated when negotiating multilaterally or bilaterally with the United States and the EU, but at the same time, was hesitant to actively organize the countries of the region because of its negative World War II legacies. Most of the other East Asian countries were not quite ready to accept such an initiative from Japan either. However, a series of events after the Asian financial crisis in 1997 described in Chapter 8, such as the unenthusiastic involvement of the United States in the reconstruction of crisis-hit economies, anti-IMF and anti-American feelings in these economies, their growing expectation for a greater regional role played by Japan and the virtual non-existence of US opposition to Japan's new role, have set a favorable environment for Japan to assume a leadership role in the East Asian region. All these events culminated in its proposal of a Japan-ASEAN Comprehensive Economic Partnership in 2002. In fact, though Chapter 8 did not elaborate, the Japanese government expressed a fear of losing potential economic benefits in the East Asian region, if it did not move towards regional FTAs. It feared those potential benefits could be poached by the United States and European countries (and more or less by China) through their respective FTA initiatives (METI 2002). Nevertheless, as Chapter 8 indicated, Japan's proposals for comprehensive economic partnership in East Asia are, at least on the part of its policy makers, expected to lead an "East Asian Community" that is not confined to economic cooperation but will include closer political linkages among members in the future: a community through which Japan can gradually dispel its lingering war time legacies in the region.

Since the East Asia Economic Group (EAEG) proposal more than a decade ago, Malaysia has wanted East Asia to become a counterforce to the United States and the EU, not only in trade negotiations but also in international relations in general. Nevertheless, it is important to remember that Malaysia's intention for the EAEG was not to form a regional FTA. Because of its economic and trade structure and domestic industry policy, Malaysia had preferred multilateral liberalization to formal FTAs. Its acceptance of and involvement in AFTA were based on its making ASEAN

regional cooperation its highest foreign policy priority, and its understanding that ASEAN cooperation allowed flexibility. The recent proliferation of bilateral FTAs, especially those initiatives by East Asian countries including ASEAN members, have caused concerns for Malaysia. Do the bilateral FTAs of ASEAN members with non-members not disrupt ASEAN cooperation and unity that should be the core of an East Asian grouping? While East Asian cooperation initiatives by non-ASEAN countries are basically welcome moves, do they have to be FTAs? And ultimately, should an East Asian grouping become an FTA? The emergence of the ASEAN+3 framework, which started as a device for regional monetary cooperation after the Asian financial crisis, provided a timely answer for Malaysia. ASEAN+3 would realize closer cooperation within the region and strongly demonstrate the East Asian stance to other regions, while FTAs under the ASEAN+3 framework, Malaysia considers, will be as flexible as AFTA because they are "ASEAN based" (Chapter 10). The Malaysian government understands now that an ASEAN consensus has been reached on its members' bilateral FTA initiatives with East Asian partners: they are "ASEAN based" and will ultimately aim for an ASEAN+3 FTA. In other words, along with the initiatives for the ASEAN+China and the ASEAN+Japan FTAs, these bilateral FTAs assure flexibility and will bring about a strong East Asian grouping, or community.

Where the ASEAN+3 framework is different from Japan's proposal of comprehensive economic partnership is its assumed membership: the ASEAN+3 does not include Australia and New Zealand. This was convenient for Malaysia, as its concept of East Asia has never included these two countries. For Australia and New Zealand, however, exclusion from the anticipated development of an East Asian FTA, and community, constitutes a serious problem as their economic relations with East Asian countries have developed over the years to the point that they absorb more than half of Australia's total export value and more than one third of New Zealand's. The strategic aims of the New Zealand government and the demonstration effects expected by the Australian government from their respective FTAs with Singapore can be seen as earnest efforts to be included in the emerging East Asian region. This motive is also behind their subsequent FTA negotiations with Hong Kong (in the case of New Zealand) and Thailand (Australia). The recent development of the AFTA-CER Linkage dialogue, in the form of the AFTA-CER Closer Economic Partnership, is a good sign for these two countries in this context, though it does not include an FTA between the two regions.

### ***Not to "Miss the Bus"***

As already implied by the explanations of motives for FTAs so far, FTA initiatives of countries that arise from various motives would induce others to do the same, and the proliferation of FTAs, will in turn, stimulate the further proliferation of FTAs. Most of the case studies illustrated that one of the main reasons for countries pursuing FTAs now is that "everyone else is doing it." This is particularly so when economic powers like the United States, Japan (and China) are involved.

If it was left behind, the Australian government argued in the initial stages, its market access to major trade partners would be significantly reduced. Thus, it also argued that their FTAs should assure equal condition to other countries, rather than try to achieve better treatment or to create trade blocs. It is interesting to observe that even the United States, which established an FTA with Canada in 1989 and subsequently formed NAFTA in 1994, thereby stimulating other countries' moves towards bilateral/regional FTAs, asserts that it has been "left in the periphery" and "isolated" from the current "boom" of FTA proliferation (Chapter 5).

Thailand also expressed its concerns about being left out of these moves. Chapter 9 pointed out that, for the purpose of establishing FTAs with its major trade partners, Thailand may be prepared to give up the WTO consistency of its FTAs to some extent. For instance, on an FTA with Japan, Prime Minister Thaksin was reported to say that the FTA can be started from where agreements were reached, which meant agriculture could be treated differently from other sectors. If this is true, contrary to the case of the FTA between Japan and Singapore, it is unlikely that the different treatment of agriculture in a Japan-Thailand FTA can be argued as WTO consistent, or rational policy for Thailand, because agricultural products are one of its important export items. It may be seen that, for Thailand at this stage, the main objective of its drive to have FTAs is to prevent isolation from the current of the times.

### ***How Can the FTA Proliferation Phenomenon Be Understood?***

The above summary of the results of the case studies confirmed that the objectives (motives) of countries for establishing FTAs are diverse and interrelated. Also, it indicated that the level of importance of each objective differed depending on the country. Based on these observations and the implicit and explicit suggestions presented by each chapter, how the recent FTA proliferation phenomenon can be interpreted by existing IPE frameworks

presented in Chapter 4—neorealism, neoliberalism and constructivism—will be discussed here. As mentioned earlier, the results of this practice have direct implications on the next discussion on the practicability of multilateralizing FTAs.

An incentive to achieve relative economic gains through static and dynamic effects of FTAs, or to prevent a change in the status quo due to other countries' FTAs that might cause relative economic losses, constitutes an essence of most countries explored in the case studies. This seems to suggest that the current "third wave" FTAs (Chapters 1 and 4) have a traditional neorealist foundation. In addition, the objective to gain influence, or stronger bargaining power, in the multilateral liberalization process by creating coalitions of like-minded partners through FTAs also implies strong neorealist motives. The reason why countries have moved towards FTAs for these purposes is, basically, the inability of the GATT/WTO system to conduct multilateral liberalization effectively. However, this malfunction of the GATT/WTO system and the proliferation of FTAs cannot be explained by the neorealist concepts of hegemonic decline and the rise of regional hegemons. These concepts cannot explain why the United States, the only superpower remaining after the Cold War, and countries like Australia, Chile, Mexico, New Zealand and Thailand, which are not regional hegemons, pursue FTAs. Rather, they have been caused by the "UNization" of the WTO based on its inherent institutional weakness in finding and keeping the fine balance between its two fundamental principles of non-discrimination and reciprocity in the period that its members have become sensitive to reciprocal liberalization.

It can be seen that the third wave FTAs are to complement the weaknesses of the GATT/WTO system. In this sense, they are expected to have the same function as the "package approach" and "code approach" that the GATT/WTO created for the purpose of maintaining reciprocity in liberalization. In other words, countries have found a new function that FTAs can play: a function that was not considered when the GATT regarded FTAs as an exception to its principles at its establishment. Moreover, if the proliferation of FTAs continues, as it seems it will, FTAs may develop into a sub-regime under the multilateral free trade regime, as the neoliberal framework suggests. Nevertheless, FTAs would likely to remain as a sub-regime at best to support the WTO because no country, maybe except Chile that already has an aspiration to cover 90 per cent of its trade with FTAs, challenges the superiority of multilateral norms over bilateral or regional arrangements.

But why does it have to be FTAs? Constructivist perspectives seem to answer this question to some extent. As Chapter 4 pointed out, constructivism

explains the proliferation of FTAs through the spread of the policy idea that they are useful in dealing with the problems of the GATT/WTO system. Constructivism also argues that, if countries act in ways that deviate from international norms, regimes or institutions in a broad sense, and many other countries emulated them in sharing the notion that the action is useful and necessary, this particular action will support a change to the international system. In fact in the case of FTA proliferation, countries do not have to worry about their deviations from the GATT/WTO system, as they are already "legal" under Article XXIV if its rather flexible conditions are taken at face value. It now seems that the idea of enhancing national interests by expanding the traditional concept of regions and building communities through FTAs has been added to the original function of FTAs to complement the GATT/WTO system. Together, these two motives add up to a strong incentive for countries to adopt FTAs.

It is important to acknowledge here that it is not any country's actions that can produce new policy ideas. Constructivism tends to emphasize ideas more than power structures or relative gains in explaining international phenomena, but the current wave of FTAs was originally caused by the US plan to strategically use FTAs and their attendant policy implementations beginning in the late 1980s. Given that Europe had already formed a Customs Union some time before and was moving towards a single market, and the United States had launched its own FTA initiatives, third countries also turned to the FTA idea. In East Asia, it can be seen that Japan's adoption of FTAs as a tangible policy option in the late 1990s has caused the current flood of FTA initiatives, or "policy bandwagoning" (Chapter 4), in the region. Malaysia's acceptance that the ASEAN+3 will aim to create an FTA is a good example. Malaysia's proposal of the EAEG, which it believes is the original form of the ASEAN+3, did not include an initiative for establishing an East Asian FTA. However, as Japan involved itself in FTAs and China followed soon afterwards in the late 1990s, Malaysia did not have much choice but to accept a future East Asian FTA. Accumulations of FTAs between small countries need to receive support from larger powers if the idea is to spread across regions and the world. In the same context, the development of FTAs into a sub-regime would not be possible if major powers like the United States, the EU, Japan and China were not involved.

Even if FTAs and their proliferation could be perceived as attempts to complement, rather than displace, the multilateral free trade regime, problems still remain. If left as they are, FTAs cannot eliminate their discriminatory and trade distorting nature. These unavoidable features of

FTAs may destabilize the multilateral free trade regime if they continue to proliferate as they are currently. Under the destabilized multilateral regime, countries may develop their FTAs further, causing a vicious circle. Moreover, if FTAs are to develop into a sub-regime, they need to be equipped with transparent principles, norms and rules. The GATT's Article XXIV is supposed to provide them, but, as mentioned in earlier chapters, what its provisions require are susceptible to various interpretations by individual countries to some extent, though they were made clearer than before when the WTO was established. In addition, countries' actual observances of Article provisions in their respective FTAs have not been monitored effectively by the WTO. Thus, under these conditions, the proliferation of FTAs risks becoming at worst just a series of preferential trade agreements with different principles and rules. More likely, as the results of the case studies suggest, different standard rules will develop in different regions: most probably Europe, the Americas and East Asia.

### **Multilateralizing FTAs: What Would Be Possible?**

Chapter 2 indicated that no economic model depicted the multilateralization of FTAs as an equilibrium point under the assumption of individually rational behavior of countries under an anarchical international system. Attempts to discuss the possibility of FTA multilateralization by so-called regionalists were unconvincing because their non-traditional model settings were perceived to be politically counterfactual. These observations are basically in line with neorealist perspectives of IPE that share the assumptions of rationality and anarchy with economic theories.

However, as the results of the case studies suggested, the current phenomenon of third wave FTAs has multiple aspects and cannot be fully understood only by neorealism. Though it has strong neorealist motives, it can be seen as the initial stage of the development of an FTA sub-regime in a neoliberal sense. Also, the constructivist approach tells us that spread of the policy idea, led firstly by Europe then by the United States, that FTAs are useful policy tools to realize national interests has caused a proliferation of FTAs through policy bandwagoning.

How do these interpretations of FTAs affect the possibility of FTA multilateralization? The following discussion on this question will conclude this volume.

### ***Increasing Membership of FTAs***

Countries negotiate and conclude bilateral FTAs as individual sovereign actors. Reflecting the neorealist foundation of FTAs, the contents of the existing agreements must be the "best" available to the parties. The accession of new members, especially under open membership systems which do not allow detailed re-negotiation of the original agreement, would inevitably change the balance between original parties. On the other hand, countries that want to join an FTA late must agree on literally everything written into the existing FTA, thereby accepting all the political preferences of the original parties. From past experience, the open membership system cannot easily be accepted both by the original members of an FTA and countries that want to join the FTA. For the purpose of having multiple members in an FTA, it seems better to engage all potential parties from the very start of negotiations.

If seen from a constructivist perspective, which emphasizes the role of ideas in expanding regions and building communities through FTAs, however, the above problem can be solved to some extent. The United States perceives its FTA with Chile is a stepping stone for the successful conclusion of the FTAA. In East Asia, the desirability of creating an East Asian community through the ASEAN+3 framework seems to be widely shared. Australia and New Zealand are active in engaging themselves in the East Asian community concept. In other words, the bases for accepting new members to FTAs, or mergers of FTAs, already exist in domestic policy orientations of individual countries. All these observations imply that expanding FTA membership is possible through the concept of a region, or a community.

Attempts to give each FTA a homogeneous content at the regional level are also possible in constructivist perspectives as they can be seen as a preparation for mergers in the future. The cases of Mexico and Chile show that NAFTA plays the role of a model FTA in the Americas. NAFTA set a standard for several bilateral free trade negotiations conducted by Mexico. It is even argued that the comprehensive nature of the Chilean FTAs, which took NAFTA as a model, are likely to reduce the problems of coordination that might arise from the multiplicity of FTAs. On the other hand, there is the reality that FTAs are tailor-made for each set of participants, making it less likely that they can be linked to promote regional or multilateral liberalization. Australia and New Zealand, though they are both open economies and even have a comprehensive FTA (CER) between them, pursued their own FTAs with Singapore—another free trading country—

because of their (small) differences in desired timing for and contents of the respective FTAs. In this sense, the real test for Japan's FTAs is how it deals with the agricultural sector in the negotiations with others after virtually excluding this sensitive sector in the Japan-Singapore FTA. If Japan could not maintain consistency with Article XXIV in other FTAs, or ended up with having FTAs with a variety of contents and provisions, its aspiration of creating East Asian Community through its FTAs would be significantly undermined.

Even if "regionalization" of FTAs was achievable, there remains an important question. How wide can these concepts of regions grow? It is often suggested that there will emerge three regional groups (or blocs) across the globe: Europe, the Americas and East Asia. Do FTA parties consider the next step? Can these groups be merged? What will happen to those countries that cannot naturally be included in any of them? Do they just have to sit and suffer the major trade diversion effects that these new regions create?

This is where international organizations, especially the WTO, are needed to play their roles. The WTO needs first to clarify what GATT's Article XXIV requires more specifically. Then, it should strengthen its power to control FTAs to make them highly consistent with its principles and provisions. 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, the formulation of APEC "FTA guidelines" based on its open regionalism principle, which will indicate the best practices of FTA formation for its members, is recommendable.<sup>2</sup>

As emphasized in Chapter 1, to strengthen institutionally weak international organizations such the WTO and APEC, support from their members is essential. Among them, support from powers such as China, the EU, Japan and the United States are the most important to create an environment that facilitates FTA multilateralization to go beyond the limit of the potential three regional blocs. The US intention of its "linear" strategy is clear. On the other hand, China and Japan have not articulated what would come next after the realization of East Asian Community. As the multilateral free trade regime still retains conceptual and normative superiority over bilateral and regional FTAs, powers can intentionally incorporate the desirability and effectiveness of future multilateralization into the FTA idea that has already proliferated. In this way, FTA sub-regime, if created, can not only complement the weakness of the multilateral trade regime but also help it get over the weakness.

### ***Making FTAs Less Discriminatory***

Forming FTAs and reducing trade barriers on an MFN basis at the same time have an effect of making FTAs less discriminatory. The latter can be done multilaterally through the WTO and APEC, or unilaterally. In a context of domestic policy preferences for FTA multilateralization, an attention should be paid to the Chilean "open regionalism" initiative. The success of Chile in adopting FTA formations and unilateral liberalization suggests that, while ensuring reciprocal liberalization through FTAs, the Chilean government and private sector could accept non-reciprocal liberalization. Also, it suggests that Chile's FTA partners accepted the unilateral liberalization of their counterpart even though it would mean the reduction of their relative economic gains that were expected when they agreed to from the FTAs with Chile. As Chapter 7 did not elaborate the factors why and how Chile could implement its version of open regionalism, conditions needed for other countries to do the same are unclear. Examination of the circumstances of Chile and comparative studies with other countries need to be conducted to see whether it is a specific case for Chile or it can be applied to other countries.

If the WTO rounds, or the APEC liberalization process, steadily proceeded and delivered comprehensive multilateral liberalization, the problems of FTA proliferation would not become major issues. In other words, a credible WTO (or APEC) liberalization process can make FTAs less discriminatory. In reality, however, the multilateral liberalization processes are not proceeding quickly or cover WTO plus elements as much as the third wave FTAs usually do.

Among the contents of the third wave FTAs, gradual multilateral application of new rules may have a chance. Generally, for parties to FTAs that set WTO plus rules on areas such as product standards, investment, finance, intellectual property rights and e-commerce, it is better if those rules were applied in wider areas than just within their own FTAs because it would reduce transaction costs significantly. The United States and Japan have already stated their intention to make their new rules in respective FTAs applied in wider areas. As mentioned earlier, US "linear" strategy of making NAFTA standards to global standards is clear. In Japan's case, there seems to be no reason to prevent participation of other countries in WTO plus rules set in its FTA with Singapore. However, it should be noted, again, that the application of new rules in FTAs to third countries may well remain within the expanded regions of the Americas and East Asia (and Europe). Existence of several standard rules on the same products or economic activities as the result, would cause frictions between them.

Alternatively, it seems possible to set up a permanent mechanism to multilateralize the contents of FTAs by using organizations outside FTAs. In particular, it may be worth considering a new WTO mechanism, which is separate from trade negotiation rounds, that picks up the rules on the WTO plus elements of FTAs for multilateralization. For the WTO to pick up some contents of FTAs that have already recognized as "de facto" standards will be relatively easy. In reality, especially at the initial stage, what the new mechanism can pick up from FTAs will be, more likely than not, the areas and levels of WTO plus rules that are included in almost every FTA, in other words, the least denominator level of rules. Nevertheless, it is still worthwhile to have such a mechanism because the rules picked up will be multilateralized, thus discriminate no country. If this mechanism developed by gathering experiences, more difficult WTO plus areas included in FTAs may be put on the negotiating table. Oppositions to multilateralizing these rules may come from within parties of FTAs or from outside FTAs. Again, support to the mechanism from WTO members will become crucial, and the role of powers will be important in incorporating the concept of multilateralization into FTA idea and facilitating negotiations, as discussed earlier.

In fact, to facilitate the application of WTO plus rules in wider areas, FTAs are not necessarily the only, or the best, tools available. These areas can be separated from FTAs and dealt with by cooperative economic arrangements based on an "open club" concept, which do not seek to disadvantage outsider, have transparent rules and norms and actively promote wider membership (Elek 1998: 8). Important aspects of this type of arrangements are that, unlike FTAs, they are not discriminatory to third countries in nature and open to outsiders to join anytime when they are ready. An open club type of arrangement has already been pursued between the EU and the United States through the Transatlantic Economic Partnership initiative (Elek 1998). For other countries like Japan, these kinds of arrangements can be an alternative to their FTA idea since the potential area in where new rules are applied is global. Efforts to create East Asian Community should be put in other areas than preferential, thus discriminatory, trade agreements.

## Notes

- 1 The fact that Thailand first approached countries with which it had minor trade relations (except Korea) for bilateral FTAs and it did so almost below water may indicate that the Chuan government was sensitive to the responses from other ASEAN members. Actually, when Singapore started FTA negotiations with New Zealand in 1999, Malaysia and Indonesia were very critical of the move, arguing that it would undermine ASEAN cooperation and unity. However, the Thaksin government's proactive pursuit of bilateral FTAs with extra-regional partners since 2001 seems to imply that it was freed from "ASEAN constraints" somehow, even before Malaysia's acceptance of such moves in 2002, provided that they are ASEAN based and would lead an ASEAN+3 FTA. Why the Thaksin government could drastically change the stance of the previous government's and what implications it has on ASEAN as a whole are interesting research questions, but they cannot be covered here.
- 2 In fact, an imitative to formulate APEC FTA guidelines was already taken by a New Zealand representative of APEC Business Advisory Council (ABAC) in 2001, but failed (interview with a support staff of a New Zealand ABAC representative, 29 November 2001). Even if the FTA guidelines were formulated, APEC members are unlikely to submissively follow them. Nevertheless, it is worthwhile to state the best practices on the issue and declare them as APEC that include powers like China, Japan and the United States.

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