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“Proliferation of Free Trade Agreements and Development Perspectives”

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I. Proliferation of FTA¹

Free trade agreements (FTAs) are undoubtedly becoming a prominent feature in the world trading system: in 1990, 27 FTAs had been reported to the GATT, and this number increased to 421 as of December 2008.² More than 90% of the Members of the WTO are participants in FTAs. Many reasons are attributed for this increase in FTAs. Undoubtedly, this proliferation of FTAs has been prompted by the failure of international trade negotiations at the WTO. WTO Ministerial Conferences failed in Seattle (1999) and Cancun (2003). Although the Hong Kong Ministerial (2005) was not a total failure, it did fail to launch trade negotiations successfully. The subsequently launched Doha Round is still stalemated. In parallel to the unsuccessful events at the WTO, trading nations negotiated FTAs with each other and came up with bilateral and regional agreements. In response to the failure of the WTO to agree on direct investment issues, trading nations also entered into many bilateral investment agreements (BIT). In 2008, the number of BITs was 2,608,³ and this number is still increasing.

At the same time, the share of FTAs in total world trade has increased tremendously. At present, the big four FTAs (the EU, NAFTA, the MERCOSUR and the ASEAN) account for 57% of the total export trade and 63% of the total import trade in the world.⁴ As seen in this figure, it is not an overstatement that FTAs are not merely an exception to the WTO system but one that parallels the multilateral trade disciplines in the WTO. The proliferation of bilateral and regional agreements may cause erosion to the disciplines of the WTO, and the effectiveness of the multilateral trading system is in jeopardy.⁵

An FTA may be an easy substitute for a difficult multilateral arrangement. Often nations in close geographical proximity share common interests. There may be common elements in culture, religion, language, history, social and economic system among such nations. Members of the EU share not only geographical proximity but also the common historical backgrounds and linguistic closeness. Nations may share some other trade interests. For example, Japan and Mexico are far

¹ An earlier version of this chapter appears in *The Law and Development Review*, Vol. 1, No. 1 (2008), 23-49.

FTA is an abbreviated form of free trade agreement. This can be a bilateral agreement or regional trade agreement (RTA), an agreement in which several countries participate on a regional basis or on the basis of some economic commonality such as NAFTA and MERCOSUR. There is an international agreement called an economic partnership agreement (EPA). Generally EPAs include not only trade concessions such as reduction and elimination of tariffs and quantitative restrictions but also other forms of arrangements such as cooperative relationships in the areas of competition policy, environment, government procurement, energy and so on. In this chapter, for the sake of brevity, the FTA is used to represent FTA, RTA and EPA unless a distinction is necessary.

² WTO website, "Regional Trade Agreement", <www.wto.org/english/tratop_e/region_e/region_e.htm>.

³ UNCTAD, *World Investment Report 2009*, p. 32, available at: <www.unctad.org/en/docs/wir2009_en.pdf>.

⁴ WTO, *International Trade Statistics 2009*, pp. 178-179, Tables A3 and A4, available at: <http://www.wto.org/english/res_e/statis_e/its2009_e/its2009_e.pdf>.

⁵ Some systemic issues with regard to the relationship between the WTO disciplines and FTAs/RTAs are extensively discussed in *Synopsis of "Systemic" Issues Related To Regional Trade Agreements*, WT/REG/W/37 (2 March 2000).

away from each other geographically, but Japan is interested in establishing an economic relationship with Mexico so that Japanese enterprises may gain access to the NAFTA market, while Mexico is interested in diversifying its trade connections and reducing its excessive dependence on the United States and the North American market. Because of these and other reasons, there has been an explosion of the WTO regime in the recent years, including, for instance, the recent noteworthy development in East Asia, that is the signing of a US-Korea FTA in 2007.⁶

East Asia has lagged behind Western and Latin American countries in creating FTAs. Recently, however, the trend toward FTAs has intensified in East Asia. For example, until recently, Korea and Japan were the only two industrialized trading nations in East Asia which had not entered into FTAs. Recently, both Korea and Japan, as well as China and other ASEAN countries, have entered into FTAs. China is working toward ASEAN+3 while Korea recently entered into an FTA with the United States. Japan is proposing ASEAN+6. Similarly, Japan has entered into an FTA with Singapore, Mexico, Malaysia, Philippines, Thailand and Indonesia. Bilateral negotiations for an FTA are also underway among Japan, Australia, Chile, India and Korea.

What is the justification for bilateral or regional FTAs where there is a multilateral trading system in operation under the auspices of the WTO? Compared with multilateral trade negotiations, bilateral and regional trade negotiations for FTAs are generally easier. FTAs may have an effect of expanding free trade beyond what can be presently agreed in the multilateral trading system: if an FTA is successful, the trade in the areas covered by the FTA is liberalized and the “zone” for the free trade has been expanded. The trade liberalization may promote economic development of the region, by increasing economic efficiency. Economic prosperity achieved by the FTA provides a greater opportunity for enterprises outside the region to trade with the region and invest in it.

However, the proliferation of FTAs presents a serious systemic problem to the WTO regime. An FTA is a preferential trading system in which each participant provides concessions to other participants in one way or another. In this sense, FTA is essentially a discriminatory system *vis-à-vis* outside parties. The most fundamental principle of the WTO, in contrast, is non-discrimination among trading nations, as expressed in Articles I and III of the GATT (most-favored nation treatment and national treatment respectively). The relationship between FTAs and the WTO is a complicated one. On one hand, there is a complementary relationship between the two in that FTAs can accomplish trade liberalization in the areas in which WTO negotiations are not successful, such as direct investment, competition, environment, and so on. In this way, FTAs can accomplish partial liberalization when trade negotiations at the WTO

⁶ For a discussion of the U.S.-Korea FTA, see Y.S. Lee, *The Beginning of Economic Integration between East Asia and North America? – Forming the Third Largest Free Trade Area between the United States and the Republic of Korea*, *Journal of World Trade*, Vol. 41, No. 5 (October 2007), 1091-1123.

come to an impasse. One might say that partial liberalization is better than no liberalization.

On the other hand, discriminatory treatment involved in FTAs creates an imbalance in the competitive conditions among trading nations and thereby causes unfairness and inequity in trading relations. This may be especially hard on developing countries outside FTA arrangements, which depend on foreign trade and the inflow of foreign capital for their economic development. Equity might also be a question for developing countries negotiating FTAs with developed countries. Where a developing country is negotiating an FTA with a developed country, the former may have no choice but to accept the demands of the partner developed country so that it does not lose the developed country market, which might be crucial. Developing countries with weak and small economies negotiating bilateral FTAs with developed countries or larger developing countries will not enjoy collective bargaining power that they may have during the multilateral trade negotiations and, as a result, may have to give up some of the multilateral protections provided under the WTO, such as special and differential treatment for developing countries. In this respect, the proliferation of FTAs is a challenge to the multilateral governance of international trading system.

Despite the perceived discrimination and inequity, the WTO, which represents multilateralism in international trade, must learn to live with FTAs because of the fact that multilateral trade negotiations are becoming increasingly difficult, and there are so many FTAs in operation. What is important from the viewpoint of the WTO is to keep FTAs at bay while utilizing the effect of liberalization accomplished by FTAs and perhaps also finding a way to minimize potential disadvantages to developing countries. In other words, an important task for Members of the WTO is to ensure that WTO disciplines are effectively applied to prevent FTAs from being too exclusive and discriminatory in relation to outside parties. Article XXIV of the GATT allows FTAs on the condition that certain requirements as specified in that article are met. The meaning of Article XXIV is by no means clear and is amenable to different interpretations. Therefore, clarifications of the key provisions of Article XXIV are needed.

With this situation in view, this chapter takes up some selected issues regarding the relationship between the WTO and FTAs. The chapter's analysis is not a comprehensive review of all the issues but rather a survey of some selected issues. However, the authors hope that the discussions made in the following passages contribute something toward the understanding of the problems surrounding the WTO and FTAs from the development perspective.

II. Proliferation of FTA and the Interests of Developing Countries

Generally, developing countries may be disadvantaged in negotiating FTAs with developed countries due to differences in economic resources and political influence. In multilateral trade negotiations such as those in the WTO, developing countries can form coalitions in which many

developing countries participate and present a united front *vis-à-vis* developed countries.⁷ While negotiating FTAs, however, developing countries, generally speaking, may not be able to rely on such a collective approach. Consequently, developing countries may be subjected to the overwhelming bargaining power of big and powerful trade partners. Powerful developed countries may engage in a “divide and conquer” strategy when negotiating FTAs with developing countries. The position of developing countries is especially vulnerable in bilateral trade negotiations since, in bilateral negotiations, the difference in bargaining power between developed and developing countries may be exploited by developed countries to impose conditions favorable to them and unfavorable to developing countries.

One way to deal with this problem may be to make use of multilateral FTAs in which, not only two, but several parties participate and in which more than one developing country are members. In this way, the existence of more than one developing country in the FTA may effectively check the imposition of hard conditions which a powerful developed country may propose. This type of FTA probably matches the reality of economic activities in the sense that modern enterprises operate not only in one or two, but in many countries. In East Asia, for example, large enterprises such as PANASONIC and TOSHIBA have a presence in several countries. In one country, parts and components are produced. Then the parts and components are exported to another country and assembled into a finished product there. In turn, the finished product is exported and consumed in a third country. In view of this multinational-economic reality, it makes sense to emphasize the importance of multilateral rather than bilateral FTAs.

Another risk for developing countries when negotiating bilateral FTAs with developed countries is that the developed country party may impose a high standard on the developing country counterpart with respect to such matters as environmental protection and foreign direct investment. It is often true, as one can see in bilateral FTAs between Japan and some Asian countries, that a developed country requires a developing country to maintain a certain level of environmental protection rather than relaxing the protection for the purpose of inducing investment from abroad. Although the protection of the environment is an important goal to which every country should strive, the environmental regulations imposed on a developing country may be too high and costly for the developing country. Although it is important for developed countries to ensure that their domestic industries are not disadvantaged in relation to counterparts in developing countries due to the difference in the level of environmental protection, the developed country party should take into account the fact that an excessively high demand for environmental protection in the developing country party may hamper its economic development. In the long run, this may even disadvantage the developed country party due to a slower economic growth of its partner.

⁷ On development aspects of the WTO, see Y.S. Lee, *Reclaiming Development in the World Trading System* (New York: Cambridge University Press, 2009). For an analysis of the issues regarding the relationship between FTAs/RTAs and BITs and developing countries, see Y.S. Lee, *Foreign Direct Investment and Regional Trade Liberalization: A Viable Answer for Economic Development?*, 39 *Journal of World Trade* 4 (2005), 701-717.

In many FTAs, provisions for direct investment are included and there are many bilateral investment agreements specifically aimed at the promotion of direct investment. Although it is generally true that direct investment from a developed country to a developing country benefits the latter by providing financial resources and transferring technology and other managerial resources, stiff requirements imposed by such provisions may interfere with development policies of the developing country party. For example, in FTAs and BITs, one often finds the requirement of most-favored treatment and national treatment. Although those are fundamental principles of foreign trade, this may hamper effective execution of development policies of the developing country party: e.g. a developing country may prefer to promote a particular industry such as the IT industry to make it a catalyst for overall economic growth and, for this purpose, subsidizes a particular group of enterprises within the country. This may run counter to the principle of MFN or national treatment, as the case may be.

The above are but two areas in which the imbalance of resources between developed countries and developing countries creates unfavorable conditions for developing countries. In order to cope with such situations, international organizations such as the UNCTAD can play a role by giving advice to developing countries which are in the process of negotiating FTAs with developed countries. The UNCTAD can also publish certain principles which govern the relationship between developed countries and developing countries and which parties of FTA negotiations should take into account when negotiating an FTA. Those principles may include equitable terms in respect to environment, investment, intellectual properties and so on. This principle would require that developed countries make certain concessions to developing countries in negotiating FTAs instead of insisting on an absolute and formalistic equality.

More fundamental concerns about FTAs between developed and developing countries should also be considered. By eliminating tariff and some of the non-tariff trade barriers, FTAs may increase consumer welfare of both developing and developed countries and thereby lead to a growth in GDP. However, tariff elimination may also hamper the long-term development potential of developing countries by depriving them of the ability to protect their domestic market from foreign competition and promote their infant industries.⁸ This exposure will have an effect of “locking” the existing competitive structure in trade between developing and developed countries: i.e. the latter being able to export more sophisticated, high value-added manufactured products and services and the former limited to exporting primary goods and relatively cheaper, labor-intensive products and services, creating large imbalances in trade gains between developed and developing countries.

Current FTAs do not include GATT Article XVIII type provisions that allow for trade measures

⁸ *Ibid.* While many economists criticize the validity of the infant industry argument, the development history of some of the most successful developing countries, such as South Korea, shows that the combination of infant industry promotion and aggressive foreign export policy can be a solution to successful economic development.

to promote infant industries. FTAs should not be used by developed countries as a means to avoid multilateral protection of the developing country interest such as that found in GATT Article XVIII. As many FTAs refer to and adopt some of the WTO provisions such as the WTO SPS Agreement, reference to and adoption of the GATT/WTO pro-development provisions, such as Article XVIII, should also be provided for in FTAs between developed and developing countries. Perhaps the UNCTAD principles as proposed above can also include these references. The WTO should also pay attention to the possible erosion of the multilateral trade disciplines by FTAs, particularly on the interest of developing countries as identified above. Consideration should be given to a possible modification of GATT/WTO rules, including Article XXIV of the GATT governing formation of FTAs, which will be explained in more detail below, to clarify that FTAs between developed and developing countries shall not undermine the developing countries' interests as protected by relevant GATT/WTO provisions.⁹

In cases where developing countries attempt to increase their exports through FTAs, non-tariff barriers of developed country partners, such as high-level of SPS regulations and complicated technical product requirements, stringent rules of origin requirements, sophisticated licensing requirements, and visa limitations against admittance of labor from developing countries, impose considerable difficulty on developing countries. FTAs between developed and developing countries seldom relax these developed country requirements resulting in the products and services from developed countries being exported to developing countries with little or no barrier thanks to the FTA arrangement, but not those from developing countries to developed countries. While there may be political difficulties with relaxing those non-tariff barriers on the part of developed countries, ways must be sought to enable developing countries to overcome these barriers to export their products and services to developed country partners. "Cumulation" allowance in the EU preferential schemes with respect to the rules of origin requirement is an example of this effort.¹⁰

⁹ Similar provisions are found in Article 11 of the WTO Agreement on Safeguards which prohibits any WTO Members from engaging in an agreement to adopt gray-area measures (e.g. voluntary export restraints), which were used to limit exports from developing countries.

¹⁰ In accordance with the EU's rules of origin principles for GSP products providing for regional cumulation, when a product is manufactured in or with inputs from two or more countries belonging to a group of countries enjoying regional cumulation, inputs from other countries of the same group are treated as if they originated in the exporting beneficiary country. The official EU website introduces three regional groups benefiting from regional cumulation: Group I consists of Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, the Philippines, Thailand, Vietnam, Singapore (though Singapore is excluded from GSP, it continues to participate to cumulation of this group); Group II consists of Costa Rica, Honduras, Guatemala, Nicaragua, Panama, El Salvador, Bolivia, Colombia, Ecuador, Peru, Venezuela; and Group III consists of Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, Sri Lanka. Caf Dowlah, *The Generalized System of Preferences of the United States: Does it Promote Industrialization and Economic Growth in the Least Developed Countries?*, 1 *The Law and Development Review* 1, (2008), p. 79, available at: <www.bepress.com/ldr>.

III. FTA within the Framework of the WTO

A. An Overview

Article XXIV of the GATT 1994, which is the governing provision on the relationship between the WTO and FTAs, was incorporated into the GATT 1947 when it came into being in 1947. At that time, there were organizations similar to FTAs, such as the British Commonwealth in which preferential tariffs existed among the Members. Therefore, the framers of the original GATT felt it necessary to allow room for preferential arrangements, such as the British Commonwealth, while imposing disciplines on the formation of FTAs. To deal with such situations, Article XXIV of the GATT 1947 was incorporated. This provision operates as the basic disciplines over FTAs today. However, as mentioned earlier, the meaning of the provisions in Article XXIV is far from being clear and there is only a trickle of decisions made by WTO panels and the Appellate Body.

B. Key Provisions of Article XXIV of the GATT

Provisions of Article XXIV of the GATT are designed to allow formation of FTAs and, at the same time, impose disciplines on them so that their discriminatory features do not distort the multilateral trading system. The key substantive provisions of the GATT 1994 are Article XXIV: 4, Article XXIV: 5(a), (b) and (c), Article XXIV: 6, and Article XXIV: 8(a) (i)(ii) and (b).

Article XXIV: 4 declares a general principle that the purpose of a customs union or of a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories.

Article XXIV: 5 sets out the conditions under which an FTA can be formed. Article XXIV: 5 (a) provides that a customs union can be formed if the duties or other regulations imposed at the institution of such union with regard to commerce with outside parties shall not on the whole be higher or more restrictive than those applicable prior to the formation of such union. Article XXIV: 5 (b) provides the same conditions with regard to a free trade agreement.

Article XXIV: 6 states that, if a Member proposes to increase tariffs above the concession rate as a result of forming a customs union, it must negotiate with other members outside the union under Article XXVIII of the GATT 1994.

Article XXIV: 8 defines customs unions and free trade areas. Article XXIV:8 (a)(i) states that a customs union is an entity in which duties and restrictions of commerce are eliminated with respect to substantially all the trade between the members of the union except those restrictions permitted under Articles XI, XII, XIII, XIV, XV and XX. Article XXIV: 8 (ii) states that a customs union establishes common tariffs and other restrictions of commerce with respect to commerce with Members that are outside parties to the union. Article XXIV:8 (b) provides the

same requirements with respect to a free trade area except that there is no requirement equivalent to (ii) which applies to a customs union.

In the past, there were many instances in which a working party was established to examine the compatibility of an FTA with GATT/WTO disciplines under Article XXIV of the GATT. However, in almost all of such working parties, there was a sharp difference of views regarding compatibility of the FTA with GATT/WTO rules and, in the reports of those working parties, usually there is two opposing views listed side by side; one advocating that the FTA is compatible with GATT/WTO rules and other criticizing that it is not.¹¹

The issue of how to interpret Article XXIV in relation to the existing FTAs was raised first when the EEC Treaty was negotiated in 1957. Between that time and 1994, 69 working parties were established to examine the compatibility of the then existing FTAs under GATT rules. In only 6 out of 69 working parties was a consensus reached.¹² The reason for this poor accomplishment was differing interests among members. Those which already formed FTAs of their own advocated their interests in maintaining those organizations and those outside the FTA criticized them. In part, the difficulty is the vagueness of the text of Article XXIV such as “substantially all,” “other trade restrictions” and “on the whole.” Only three panels were established to examine the legality of FTAs in light of Article XXIV but, in all of them, the panel reports were not adopted.¹³

C. Understanding on the Interpretation of Article XXIV of GATT 1994

Attempts were made to clarify the meaning of Article XXIV of the GATT 1994 in the Uruguay Round. As the result, a limited number of issues were clarified.

1. General

- a. The level of tariffs should be calculated by using weighted average rates.
- b. The period for the completion of an FTA is in principle 10 years.
- c. When a member of a customs union raises tariffs above the concession rate as a result of joining the customs union, that member should negotiate with outside WTO Members in accordance with XXVIII of the GATT 1994.
- d. An outside Member which enjoys the reduction of tariffs due to the joining of a member in a customs union is under no obligation to offer compensation.

¹¹ Japanese Ministry of Economy, Trade, and Ministry (METI), Industrial Structure Council, *2006 Report on the WTO Consistency of Trade Policies by Major Trading Partners* (2006), p. 495, available at: <http://www.meti.go.jp/policy/trade_policy/wto_consistency_report/html/f_y2006e.html>.

¹² *Ibid.*

¹³ *Ibid.*

2. Article 4.3 of the Anti-dumping Agreement

When the degree of integration of a customs union has reached the level as provided for in Article XXIV: 8 (a), the totality of an industry in the region covered by the customs union is deemed to be a domestic industry.

3. The principle articulated in 2 above, also applies to the application of countervailing duties.

4. Article XXI: 1, footnote

No provision in Article XXIV of the GATT 1994 prejudices interpretation of the relationship between Article XIX of GATT and Article XXIV: 8 of the GATT 1994.

5. “Substantially all” – the interpretation of Article XXIV: 8 of GATT 1994

The meaning of “substantially all” in Article XXIV: 8 is a controversial subject in the interpretation of that article. Article XXIV: 8 states that “substantially all of trade” must be liberalized if a customs union or a free trade area is qualified for exemption under Article XXIV. A question is what the phrase “substantially all” means: i.e., what the rate of liberalization of internal trade meeting the requirements is and whether it is a quantitative requirement only or both quantitative and qualitative requirement. If it is merely a quantitative requirement, there is room to interpret this to mean that “substantially all” is satisfied even if, for example, agricultural sector of a customs union or a free trade area is not liberalized as long as the trade of the customs union or the free trade area is quantitatively liberalized on the whole. For example, the portion of import of agricultural products from Korea to Japan is about 10% of the total imports from Korea. If the 90% quantitative test is adopted, this may mean that the exclusion of agricultural sector is justified as long as other sectors are totally liberalized.

However, if the test is a qualitative as well as quantitative one and if the quantitative liberalization is taken to mean that all major sectors of trade should be liberalized, a mere fact that the trade of a member country is liberalized as the whole may not be sufficient for the customs union or free trade area to be exempted under Article XXIV if a particular sector (for example, agriculture) is not liberalized. In this view, the total exclusion of Korean imports of agricultural products to Japan would not be justified.¹⁴

This question was raised many times even before the WTO was founded in 1995. The question was raised once in connection with the EFTA (the European Free Trade Association) when the Treaty of Stockholm exempted agriculture from the liberalization. In the Working Party, there

¹⁴ In fact, it has been known that the Japanese demand for a substantial exclusion of the agricultural sector from trade liberalization is the reason for the current suspension of FTA negotiations between Korea and Japan since November 2004.

was a view that “substantially all” should be interpreted to have not only quantitative but also qualitative features. This view maintained that even if the rate of liberalization of internal trade reached 90% quantitatively, this should not be regarded as an automatic approval of the FTA.¹⁵ The representatives of the EFTA maintained that Article XXIV of the GATT 1947 allowed some restrictions with regard to products by providing that “substantially all of trade” instead of “substantially all products.” Although no consensus was reached in the Working Party, the prevailing view was that both qualitative and quantitative tests should be used.

Another Working Party which examined the EEC-Finland Free Trade Agreement in 1973 took the view that the “substantially all” test should be interpreted to mean liberalization of all products and that exemptions for particular sectors of the economy should not be allowed.¹⁶ From this view, to exempt an entire sector of the economy from liberalization would be contrary to Article XXIV of the GATT no matter what the quantitative coverage of this sector may be in the total trade. The Preamble of the Understanding on the Interpretation of Article XXIV of the GATT 1994 endorses this view by stating that if main areas of trade are exempted from the obligation to abolish restrictions, the contribution of FTAs toward liberal trade is reduced.

The Working Party which reviewed the US-Canada Free Trade Agreement took a positive view toward the Agreement because it did not attempt to exclude the agricultural sector as the whole from liberalization. Some Contracting Parties did express skepticism to the Agreement since some specific agricultural products (such as fresh fruits, vegetables, corn and corn products, eggs, and milk products) were exempted.¹⁷ In those Working Parties, a focus of discussion was the treatment of agricultural sectors and products.

In view of this, the WTO Secretariat issued a report in 1998 in which it examined 69 FTAs and RTAs and stated that 56 FTA agreements excluded some agricultural products and, in 2 FTA agreements, all of agricultural products were excluded.¹⁸ As one can see from this finding, agricultural issues are an “Achilles Heel” for the WTO and FTA.

From the perspective of economic development, the trend against exclusion of agriculture in FTAs can be considered a positive development for developing countries since many developing countries tend to have a competitive advantage in agriculture products in trade relations to developed countries, *vis-à-vis* manufactured products in which developed countries tend to have a competitive advantage.

There is also certain regulatory advantage to developing countries in formation of FTAs: a

¹⁵ BISD, 9S/84-85.

¹⁶ BISD, 21/79.

¹⁷ BISD, 38S/73.

¹⁸ WT/REG/W/26.

GATT decision promulgated on 28 November 1979, which is called the “Enabling Clause,”¹⁹ relaxed this requirement of “substantially all of trade” by providing exemption from the MFN requirement in GATT Article 1 with respect to “regional or global arrangements entered into amongst *less-developed contracting parties* for the mutual reduction or elimination of tariffs.”²⁰ The enabling clause states that developing countries are not required to liberalize “substantially all of their trade” as long as FTAs between developing countries offer mutual reduction or elimination of tariffs.²¹ An argument has been raised that this special and differential treatment under the Enabling Clause is not sufficient because it only applies to FTAs between developing countries and not those between developed and developing countries.²²

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

This phrase is found in Article 24:5 (a) which requires that tariffs and other trade restrictions imposed by an FTA on outside parties shall not on the whole be higher or more restrictive than those before the formation of the FTA. This provision minimizes the discriminatory impact of FTAs on outsider parties by requiring the participants of an FTA to keep the *status quo* with regard to trade restrictions, which the participants adopted prior to the formation of the FTA.

However, the regulatory restraint from raising tariffs and other trade barriers against outside parties does not mean that the non-FTA parties, particularly vulnerable developing countries, will not suffer from “relative disadvantages” created by the FTA. For instance, if country A, which has signed an FTA with country B, maintains its pre-FTA tariffs on product X at 10%, the FTA has not increased tariffs and other trade barriers under Article XXIV, but the non-FTA party country C which exports product X to country A will then have a disadvantage since country B can produce and export product X to country A tariff free, while country C is still subject to the 10% tariff on product X. The effect of this relative disadvantage will be more significant to many developing countries which rely on export of price-sensitive, labor-intensive products and thus are competing on a very narrow price margin.²³ The FTA advantage will eliminate those competitive margins for non-FTA signatory developing countries.

With regard to tariffs, Article 1 (a) (i) of the Understanding on Interpretations of Article XXIV of the GATT 1994 provides that, for the purpose of Article XXIV: 5 (a), the weighted average rate should be used to determine the restrictiveness. The phrase “on the whole” seems to suggest

¹⁹ GATT, *Decision on Differential and More Favorable Treatment and Reciprocity and Fuller Participation of Developing Countries*, L/4903 (28 November 1979).

²⁰ *Ibid.*, para 2(c).

²¹ See Won-Mok Choi, *Enabling Clause or Disabling Clause? - Legal Problems of Making Regional Trade Agreements with Less-Developed Economies*, paper presented at the Society for International Economic Law inaugural conference, Law and Development Panel, 16 July 2008.

²² *Ibid.*

²³ Hence many developing countries may be pushed to sign an FTA with developed countries that provide major export markets for them with the terms dictated by the latter countries for fear of losing their essential markets.

that the weighted average level of tariffs of the members of an FTA before the formation of an FTA should be comparable to that which resulted from the formation of an FTA.

There is another issue of interpretation with regard to “other trade restrictions” in Article XXIV: 5(a). For example, rules of origin can be an issue. As to whether rules of origin are “trade restrictions” in the meaning of Article XXIV, there are two opposing views. In the Working Party that examined the compatibility of the NAFTA with GATT rules, the United States argued that rules of origin are not trade restrictions in the same sense as tariffs and quantitative restrictions are.²⁴ From this view, rules of origin are a test to determine which product benefits from the preferential treatment of an FTA but not a trade restriction in itself. Rules of origin do not erect barriers in the same way as tariffs and quantitative restrictions. The other view is that rules of origin are a very important trade issue and may operate as *de facto* trade restriction. In the Uruguay Round Negotiation, negotiators tackled the issue of whether or not rules of origin were “other restrictions.” However, they were unable to reach any conclusion as to whether they were “other restrictions”²⁵.

If rules of origin are “other restriction of trade” under Article XXIV, there is a problem. Article XXIV: 5 (a) requires that trade restrictions after the formation of an FTA shall not be higher or more restrictive than those before its formation. The question here is: what is “before”? If an existing FTA is enlarged to another, more expansive FTA (such as the transformation of the US-Canada Free Trade Agreement into the NAFTA), the answer may be a comparison between the common rules of origin at the time of the US-Canada Free Trade Agreement with that of the NAFTA. However, what if a new FTA is entered into? There were no common rules of origin before. The common rules of origin were created only after the formation of the FTA. Then the question is what rules should be compared with what rules. Should the common rules of origin be compared with those of each Member at the time before the formation of the FTA? However, a Member may have adopted “tariff classification rule” while others may have adopted “the substantial transformation rule.” This would make it very difficult to make any consistent comparisons.

In the Uruguay Round Negotiation, negotiators discussed the issue of rules of origin in the context of FTAs. However, the outcome was only a statement that there should be transparency in the enforcement of rules of origin in FTAs. Other issues are left to future negotiations and clarifications. No progress has been made on this issue.

The export by developing countries has been hampered by complex and stringent rules of origin adopted by major developed economies.²⁶ The stringent rules of origin can also reduce the

²⁴ WT/REG/M2 (21 February 1997), p. 10.

²⁵ See WTO, *Background Note by the Secretariat, Systemic Issues Relating to “Other Regulations of Commerce”*, WT/REG/W17 (October 31, 1997).

²⁶ Stefano Inama, *Market Access for LDCs: Issues to Be Addressed*, 36 *Journal of World Trade* 1 (2002), 115.

export opportunities created by FTAs for developing countries. Thus regional or bilateral FTAs should be used as an opportunity to relax the rules of origin to maximize the benefit from the FTAs and not as one to reinforce them so as to limit them.

IV. Are FTAs “WTO Plus”?

A. An Overview

As stated earlier, FTAs provide rules in areas where the WTO has failed to do so. Examples include investment, competition policy, and the environment. FTAs include provisions for trade in services and movement of persons, which are lacking or incomplete in the WTO. When FTAs supply rules in the areas in which the WTO has not successfully addressed, FTAs fills in the lacuna. In this way, FTAs are “WTO Plus.”

FTAs also provide rules for the subject matters covered by the WTO. Examples include, *inter alia*, trade remedies (anti-dumping, countervailing duties and safeguards), intellectual property and dispute settlements. In such areas, complicated problems may occur. On one hand, rules in FTAs on these subjects add new rules. For example, the FTA between Singapore and New Zealand incorporates a *de minimis* rule that if a dumping margin is less than 5% (instead of 2% as provided for the Anti-dumping Agreement), an anti-dumping investigation should be terminated.²⁷ One may argue that this additional rule is “WTO Plus” because this is a new principle which regulates the enforcement of anti-dumping legislation and which the WTO has not been successful in introducing.

This additional rule applies only to the participants of the FTA and, therefore, it is a discriminatory measure in relation to outside parties. It creates an inequality of treatment among WTO Members and, therefore, may be problematic.

Dispute settlement procedures are also incorporated into many FTAs. There is a possibility that rules developed through dispute settlement procedures of an FTA may differ from those of the WTO when an FTA and the WTO cover the same areas. In the future there may be a need for some sort of arrangements between the WTO and FTAs whereby such contradictions and inconsistencies are eliminated or minimized. At the end, this paper proposes an “FTA Network” in which participants of different FTAs may join, exchange information with regard to detailed rules of the FTAs and explore possibilities for reducing or minimizing difference of rules. The WTO could also publish a non-binding model dispute settlement procedure code. The idea of

²⁷ Ministry of Economy, Trade and Industry of Japan, *2007 Report on Compliance by Major Trading Partners with Trade Agreements – WTO, FTA/EPA, and BIT* (April 2007) (hereafter referred to as “2007 Report”), p. 550, available at: <www.meti.go.jp/policy/trade_policy/wto_compliance_report/html/f_y2007_e.html>.

this code would merely be to show basic principles in international dispute settlement so that drafters of FTAs might take them into consideration.

While FTAs create new rules that the WTO has not created and, in this way, contributes something toward the liberalization of trade, this liberalization is partial and preferential in that it applies only to the FTA participants. This is a mixed blessing for the multilateral trading order. It liberalizes trade at least partially where the WTO cannot accomplish it and, in this sense, the total liberalization of the world trade may be greater than otherwise. However, due to the inequality of conditions among WTO Members created by the formation of FTAs, trade may be diverted from its normal flow. Whether advantages created by FTAs outweigh its disadvantages depends on the particular conditions of the FTAs.

In contrast, FTAs between developed and developing countries may be called “WTO Minus,” in the sense that the multilateral protection of developing country interest, such as GATT Article XVIII mentioned earlier, is not incorporated in its provisions. One may argue that the inclusion of such provisions may not be proper for FTAs because the objective of FTAs is to reduce or eliminate trade barriers and not allow developing countries to erect them. However, FTAs should be considered in the overall context of the economic development objectives of developing countries – FTAs should be regarded as a means to improve the economic conditions of developing countries and not the end in itself, thus the ability of developing countries to adopt trade-related development policies should be preserved even after the signing of an FTA.

There might be another argument that developing countries entering into an FTA should consider the implications of joining an FTA, including that they may no longer be able to adopt trade measures to promote their industries *vis-à-vis* the developed country partner of the FTA. However, global economic realities are such that many developing countries, particularly those with small and vulnerable economies cannot afford to be excluded from preferential trade arrangements of powerful developed countries, for the fear of losing vital export markets as illustrated earlier. This inequality of bargaining power is an important reason why ways should be sought to ensure that multilateral protection of developing country interests should not be eliminated by FTAs.

In the following passages, a brief discussion will be made on some areas to examine the relationship between FTAs and the WTO from the development perspective. Those areas are investment, competition policy, trade remedies and dispute settlement. They are but a few of many that need to be discussed. Nevertheless preliminary reviews of those areas reveal the nature of issues involved in the relationship between FTAs and the WTO.

B. Investment

Investment issues are part of the Singapore Issues²⁸ and are included in the Doha Agenda.²⁹ However, the WTO Ministerial Conference in Hong Kong (2005) decided that investment issues would not be taken up in the upcoming negotiation. Therefore, at least for a while, any agreement on investment is left to BITs, FTAs or RTAs. Nonetheless, investment-related provisions are found in the WTO. One is the TRIMs Agreement and the other is the GATS. The TRIMs cover investment measures that affect international trade such as local content and export performance requirements. The Mode 3 of the GATS directly relates to direct investment issues in services sectors. However, provisions in the WTO dealing with investment issues are piecemeal and there is no agreement in the WTO regime which deals with investment issues in a comprehensive way. On the other hand, as mentioned earlier, there are many FTA and BIT agreements among WTO Members and also non-Members.

In those FTAs/BITs, there are several principles relating to conditions of international direct investment.³⁰ Major ones include, *inter alia*, principles of national treatment, most-favored nation treatment and fair and equitable treatment. The national treatment principle requires that the Host Country Party (the country receiving direct investment) accord to investment and investors from the Home Country Party treatment in laws, regulations and other governmental measures which are no less favorable than the treatment that it accords to domestic investments and investors. The most-favored nation treatment requires that the Host Country Party accord treatment to investment coming from the Home Country Party which is no less favorable to that accorded by the Host Country Party to investment coming from any third parties.

The fair and equitable treatment principle requires that the Host Country Party provide fair and equitable treatment as well as full protection and security to investments and investors coming from the Home Country Party.³¹ In this principle, the issue is not a relative advantage or disadvantage that investors and investors from the Home Country Party receive compared with those received by domestic investments and/or those from third countries. The principle requires that the Host Country Party give certain standards of fair and equitable treatment to investments and investors coming from the Home Country Party. In this sense, it sets up an absolute standard as opposed to a relative standard in relation to investments and investors from domestic sources

²⁸ In the WTO Ministerial Conference held in Singapore in 1997, Members agreed to explore the possibility of introducing agreements on investment, competition policy, trade facilitation and government procurement. Those items are called the Singapore Issues. Working groups were established to study the relationship between trade and investment and that between trade and competition. However, in the Ministerial Conference held in Hong Kong in 2005, Members decided not to take up the Singapore Issues.

²⁹ On issues of investment in the WTO, see Mitsuo Matsushita, 'North-South Issues of Foreign Direct Investments in the WTO: Is There a Middle-of-the-Road Approach?', in Steve Charnovitz, Debra P. Steger and Peter Van den Bossche (eds), *In Law In the Service of Human Dignity* (Cambridge University Press, 2005), pp. 76-89.

³⁰ See 2007 Report, *supra* note 27, pp. 624-625.

³¹ 2007 Report, *supra* note 27, p. 625.

and other countries. The major contents of fair and equitable treatment consist of items including due process of law in dealing with investment, the prohibition of denial of justice and capricious treatment, and the protection of reasonable expectations of investors.

There has arisen a question of whether or not this principle requires any higher standards than those which already exist in public international law. The NAFTA Free Trade Commission decided in 2001 that it did not.³²

In some FTAs/BITs, there are provisions prohibiting performance requirements. Performance requirements include local content requirements and the export/import balancing requirements as provided in the TRIMs Agreement. However, FTAs/BITs add some more prohibitions, including those against the restrictions imposed on domestic sales in connection with investment, the requirement for transfer of technology and the requirement that all directors or some directors of an enterprise established by the investment should be nationals of the Host Country Party.

Some FTAs adopt the positive list formulae in which liberalization of investment and the principles mentioned above apply only to those areas stated in the list of liberalization commitment and some others adopt the negative list formulae in which the parties agree to liberalize foreign investment generally except for the areas listed in the liberalization commitment as excluded from the liberalization. FTAs entered into between developed countries tend to adopt the negative list formulae as shown in the NAFTA and FTAs in which developing countries are parties tend to go along with the positive list approach as exemplified by the Australia-Thai Agreement and the India-Singapore Agreement.³³

Another issue dealt with in FTAs in respect to direct investment relates to expropriation and compensation. The general principles here are that expropriation should be for public purpose, that it should be non-discriminatory, that it should be made in accordance with the due process of law and that an appropriate compensation should be paid.

Provisions for expropriation in FTAs often include those for indirect expropriation. Another name for indirect expropriation is “creeping expropriation” and includes such practices by the Host Country Party as capricious withdrawal of authorization of enterprise activities and a setting of the maximum level of production allowed for foreign investors. In the Metalclad Case,³⁴ the issue was whether environmental measures taken by the Mexican Government amounted to indirect expropriation under the NAFTA Agreement, and the NAFTA arbitration panel awarded a judgment favorable to the investor.

Provisions on investment are clearly “WTO Plus.” International rules on direct investment has

³² *Ibid.*

³³ 2007 Report, *supra* note 27, p. 626.

³⁴ 2007 Report, *supra* note 27, p. 627.

been discussed and negotiated in international forums such as the WTO and the OECD without success. At present, the formation of international rules through BITs and FTAs is the only choice that the international trading system has as regards to investment. Although rules in BITs are partial and piecemeal, they serve to promote international investment.

From the perspective of development interests, the current trend toward the “liberalization of investment” under FTAs protects the interest of developed country investors rather than that of the host developing countries. For instance, many FTAs/BITs prohibit a wide range of TRIMs that are designed to maximize the contribution of foreign investment toward the economic development of the host developing countries. Investor-state dispute settlement provisions in FTAs and BITs that allow the aggrieved foreign investors to raise claims against the government of the host country through arbitration may also put developing countries under pressure by making it difficult to adopt economic development policies and public policies that may adversely affect the interest of foreign investors. While foreign investment may bring essential capital, technology, and managerial expertise that could contribute to the economic development of the host developing countries, some latitude should be allowed for the host developing countries to regulate foreign investment in a way to increase its contribution toward the goal of economic development.³⁵

In general, promotion of “greenfield investment” rather than mergers and acquisitions would be more advantageous to developing countries as it creates productive capacities in the latter countries. Well structured safeguard and safety net provisions should also be incorporated into investment agreements between developing countries and developed countries. Positive list formulae are perhaps more advantageous to developing countries since this approach allows developing countries to identify and open the areas in which foreign investment is most desirable for economic development.

C. Competition Policy

Competition policy is one of the items included in the Singapore Issues and in the Singapore Ministerial Conference in 1996, WTO Members decided to set up a working group to study the relationship between competition policy and trade.³⁶ Accordingly, the Working Group on Trade and Competition was established within the WTO and the Working Group turned out reports.³⁷ However, the Hong Kong Ministerial Conference held in 2005 decided not to take up trade and competition policy and, as the result, this topic is held outside the scope of negotiation as far as

³⁵ *Supra* note 7.

³⁶ On the relationship between trade and competition generally, see Mitsuo Matsushita, *Basic Principles of the WTO and the Role of Competition Policy*, 3 Washington University Global Studies Law Review 2 (2004), 363-385.

³⁷ WTO, *Working Group on the Interaction between Trade and Competition Policy*, Report to the General Council, WT/WCTP/1 (Nov. 28, 1997), WT/WGTCP/2 (Dec. 9, 1998), WT/WGTCP/3 (Oct. 11, 1999) and WT/WGTCP/5 (Oct. 8, 2001).

the Doha Agenda is concerned.

Many FTAs include provisions for competition policy and these provisions supply additional rules concerning trade and competition in international trade. Competition policy provisions incorporated in FTAs generally fall roughly into two categories, e.g., the NAFTA type and the EU type. In the former, competition policy provisions do not provide substantive rules such as the prohibition of cartels on a *per se* illegality basis and the control of vertical restraints on a rule of reason basis but leave them to the national laws of each party. If there is no competition law in a party to the FTA, that party is requested to enact competition law or to implement it. In the latter, the customs union (such as the European Communities) enforces its own “supra-national” competition law with its own enforcement mechanism (such as the European Commission and the European Court of Justice). Most of competition policy provisions incorporated in FTAs belongs to the former type.

Many FTA provisions related to competition policy can be likened to those incorporated in bilateral competition policy agreements entered into by some major trading countries. Japan entered into such agreements with the United States, European Communities and Canada. Major rules incorporated in such competition policy provisions fall into, *inter alia*, the following categories, i.e., negative comity, positive comity, notification and consultation, exchange of information and cooperation in enforcement. Negative comity is a principle that a nation that is a party to an agreement on competition policy, refrains from enforcing its competition law *vis-à-vis* conduct that affects the interest of the other party, out of respect for the policy of the other party. Positive comity denotes that a nation which is a party to an agreement on competition policy requests the other party to enforce its competition law *vis-à-vis* a conduct which affects the interest of the former and which occurs in the domain of the former.³⁸

As an example, competition policy provisions in the Japan-Singapore Agreement are explained below. Chapter 12 is devoted to competition policy. As set out in this chapter, the basic objective is to take appropriate measures against anti-competitive conducts engaged in by private enterprises in order to maintain smooth flow of trade and investment and thereby efficiency in international trade. When this agreement entered into effect, there was no competition law in Singapore and, therefore, the Agreement merely provided that the parties endeavor to enact, review and amend necessary laws and regulations pertaining to anti-competitive conducts. It is hortatory rather than obligatory and has no legally binding effect on the parties. However, the existence of this provision prompts the participants to enact and enforce competition laws if they do not have them yet and, in this way, contributes toward establishing international competition policy. Article 104 of the Agreement provides that both Parties cooperate in enforcement of competition policy and laws according to their respective laws and regulations and as much as their resources allow. As to details of cooperation, the Agreement provides for notification,

³⁸ On comity issues, see United States Department of Justice and Federal Trade Commission, *Antitrust Enforcement Guidelines for International Operations* (April 1995), pp. 22-27.

exchange of information, technical assistance, use of information in criminal procedures, the scope of application, regular reviews and expansion of cooperation and consultation. It is to be noted that competition policy matters are excluded from the dispute settlement procedures of the Agreement.

In almost all FTAs/EPAs in which Japan is a party, there are provisions pertaining to competition policy, which are similar to the ones mentioned above.³⁹

Competition policy promotes free trade by eliminating private anti-competitive conducts which would offset the effect of liberalization achieved through trade negotiation. In this sense, competition policy provisions incorporated into FTAs/RTAs are complementary to the WTO regime and can be characterized as “WTO Plus.” Also it is to be noted that the essence of competition policy and law is non-discrimination and there is little danger that competition laws incorporated into FTAs are applied discriminatorily.

Enforcement of competition law by way of FTAs is a mixed blessing for developing countries. On the one hand, competition law can be used to control anti-competitive behavior by dominant multinational companies from developed countries and protect smaller and weaker domestic enterprises of developing countries. On the other hand, strict application of competition law may not be consistent with the need of developing countries to adopt industrial policies that will involve mobilization and concentration of resources in large-scale manufacturing-based companies, which will, in turn, enjoy dominant positions in domestic markets. It should be noted that newly industrializing countries in the 1970’s and 80’s, including Korea, strategically supported and promoted large-scale manufacturing companies such as Hyundai and Samsung as a means to build internationally competitive industries, and strict application of competition law would have been made this support difficult. A compromise should be sought between competition policy and development policy.

D. Trade Remedies

In many FTAs, there are provisions for trade remedies, e.g., anti-dumping, countervailing duties and safeguards. When parties to an FTA are also WTO Members, this may raise complicated and systemic problems.

In relation to WTO jurisprudence, whether or not trade remedies can be lawfully applied within an FTA is an important question. Article XXVI: 8 of the GATT 1994 states that tariffs and trade restrictions must be liberalized but measures under Articles XI, XII, XIII, XIV, XV and XX are exempted from the obligation to liberalize. It is to be noted that Article XIX of the GATT (safeguards) and Article VI (anti-dumping and countervailing duty measures) are not mentioned

³⁹ See 2007 Report, *supra* note 27, pp. 63-66.

here. Does this mean that the obligation to liberalize applies to the trade remedy measures and there is an obligation under Article XXIV: 8 of the GATT for a member of a customs union or a free trade area to refrain from applying a safeguard, anti-dumping, or countervailing duty measures? One view is that a member of a customs union or a free trade area which is also a Member of the WTO may apply none of these measures to imports coming from other WTO members which are not members of the customs union or a free trade area while not applying the same measures to members of the customs union or a free trade area.

On the other hand, there is a counter-argument that the trade remedy measures, such as safeguards, anti-dumping and countervailing duty measures, apply even within the FTA area. The rationale for this interpretation is that the premise of trade remedy measures is that trade is already liberalized. If trade is not yet liberalized, there is no need for trade remedy measures. Trade remedy measures apply once trade is open. In this view, trade remedy measures apply within the FTA area since the essence of an FTA is to liberalize trade.

In the past few years, several important decisions were rendered by the WTO Appellate Body in which the issue was whether a WTO Member who is also a member of an FTA can exclude from the application of a safeguard measure imports of the product in question coming from countries that are members of the FTA. Important cases include the Argentina Footwear Case,⁴⁰ the United States-Wheat Gluten Case⁴¹ and the United States Lamb Case.⁴² In the Argentina Footwear Case, Argentina took into account the import of footwear from MERCOSUR when determining injury to a domestic industry but excluded the application of a safeguard measure to the import from the members of MERCOSUR. The EC challenged this practice at the WTO and both the Panel and the Appellate Body ruled that the selective application of safeguard measure by Argentina was contrary to Article I and cannot be exempted under Article XXIV: 8 (a)(i) of the GATT 1994.

In all of those cases, the Appellate Body announced that there should be a parallelism between the scope of the investigation for a safeguard measure conducted by a Member and the scope of the safeguard which is applied as the result of it. The Appellate Body in the above cases ruled that a WTO Member cannot exclude imports coming from WTO Members, that are also members of an FTA, from the imposition of a safeguard measure, while applying the safeguard measure on imports of the same or like product coming from other WTO Members that are not members of the FTA, as long as the safeguard investigation was conducted with regard to imports of the product coming from all of the countries. This principle applies unless there is persuasive evidence that the imports coming from the WTO Members, that are also members of

⁴⁰ See *Argentina-Safeguard Measures on Imports of Footwear*, WT/DS121/R (14 December 1999).

⁴¹ See *United States-Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities*, WT/DS166/AB/R (22 December 2000).

⁴² See *United States-Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia*, WT/DS177/AB/R and WT/DS178/AB/R (1 May 2001).

the FTA, did not contribute significantly to the injury to the domestic industry.

However, the parallelism as enunciated by the Appellate Body does not resolve the question of whether or not Article XXIV can be raised as a defense by a Member when challenged for discriminatory treatment in favor of other FTA Members with regard to safeguards. This issue was raised in the *United States-Line Pipe from Korea Case*⁴³ in which Korea challenged the imposition of a safeguard measure on imports of line pipe from Korea. The Panel held that Article XXIV could be invoked as a defense to claims of violation of provisions in the GATT 1994 and Korea appealed this finding. The Appellate Body reversed the Panel's finding that the United States did not violate its obligations under Articles 2 and 4 of the *Agreement on Safeguards* by exempting Canada and Mexico from the line pipe measure. It, however, dismissed the Korean appeal on the ground that the question of whether Article XXIV serves as an exception to the requirement of non-discrimination under the GATT arises only in two situations: (a) that the administering authority did not consider imports coming from countries that are members of an FTA in determining injury issues and (b) that the administering authority determines that imports coming from Members outside the FTA alone are sufficient to cause a serious injury to a domestic industry. The Appellate Body reasoned that, since neither of such situations existed in this case, this issue was legally moot.

A legal question that Article XXIV presents in relation to trade remedies to be applied within FTAs is whether trade remedies are allowed if, after applying trade remedies, substantially all of the internal trade of an FTA is still open. Since the language of Article XXIV requires that there should be liberalization within an FTA of “substantially all” of the internal trade but does not require “all” of the internal trade of an FTA to be open, there may be room for some trade restrictions within the FTA as long as substantially all of the internal trade is open. Does this mean that trade remedy measures applied within an FTA are allowed as long as they remain within this limit? The liberal reading of the text seems to allow this interpretation, which was suggested by the Appellate Body in the *Argentina Footwear Case*.⁴⁴ If this interpretation is accepted, it may cast doubt on the legitimacy of an argument that Members of the WTO which are also members of an FTA are obligated to exclude the internal trade within the FTA from the application of trade remedy measures under Article XXIV of the GATT 1994 and that this exclusion is exempted from the MFN obligations. This is because Members of the WTO which are also members of an FTA can apply trade remedy measures as long as substantially all of the internal trade of the FTA remains open.

In another scenario, a trade remedy measure that a WTO Member which is also a member of an FTA applies may have such a great impact on the internal trade within the FTA that substantially all of the internal trade of the FTA is no longer open. If this should be the case, an application of

⁴³ See *United States-Definitive Safeguard Measures on Imports of Circular Welded Carbon Quality Line Pipe from Korea*, WT/DS202/AB/R (15 February 2002).

⁴⁴ See 2007 Report, *supra* note 27.

a trade remedy measure within an FTA cannot be justified. A determination as to whether a particular trade remedy measure would restrict the trade within an FTA to the extent that substantially all of the internal trade within the FTA is no longer liberalized should be made on a case-by-case basis. In any event, the requirement of this justification will set a serious limitation on the application of trade remedy measures within FTAs.

In some FTAs, provisions containing trade remedies merely incorporate rules declared in the Anti-dumping Agreement of the WTO and other relevant WTO agreements. However, in some other FTAs, there are provisions that supply disciplines on invocation of trade remedies that are more stringent than those provided for in WTO agreements. For example, in the Agreement between Singapore and Australia, the *de minimis* anti-dumping margin and the negligible amount of import below which the enforcement agency cannot impose anti-dumping duties is set at 5%, as opposed to 2% and 3% in the WTO Anti-Dumping Agreement, respectively.⁴⁵

In the Australia-New Zealand Agreement, the Parties decided to abolish anti-dumping duties in the trade between them and to apply competition rules to anti-competitive conduct that affect trade between those two countries. Similarly, in the Agreement between Canada and Chile, anti-dumping duties were abolished after 2003 and competition laws would apply to control dumping between those two countries.⁴⁶

With respect to safeguard measures, many FTAs incorporate rules of the WTO Safeguard Agreement as well as GATT XIX. However, in some FTAs, more stringent restrictions on invoking safeguards are imposed. For example, in the Japan-Singapore EPA, the application of safeguards is limited to cases in which there is an absolute increase of import and no provisional measures are allowed. Moreover, the application of safeguards is limited to the interim period (10 years since it started).

Negotiations on trade remedies in the WTO are difficult. This is especially true with anti-dumping matters and, in this respect, FTA provisions that impose higher disciplines on invocation of trade remedies contribute toward further liberalization of trade. In this way, FTAs are WTO Plus. However, FTAs also create unequal treatment with regard to trade remedies among FTA members and non-members, and therefore deprive WTO Members outside FTAs of a “level playing field.” In this sense, FTAs are both “WTO Plus” and “WTO Minus.” Whether “Plus” is greater than “Minus” depends on the specific situation. It is submitted that coordination and harmonization among trade remedy systems in the WTO and various FTAs are needed. It is important to note that, when harmonization among FTA rules is attempted, the WTO should introduce upgraded trade remedy rules to match more liberal provisions on trade remedies in some FTAs rather than downgrading liberal provisions in FTAs to a less liberal standard of the trade remedy provisions in the WTO.

⁴⁵ 2007 Report, *supra* note 27, p. 550.

⁴⁶ 2007 Report, *supra* note 27, p. 553.

The trade remedy measures of primary importance to developing countries are anti-dumping measures. Primary targets of anti-dumping measures are cheaper exports from developing countries, and anti-dumping measures have been used as convenient tools to protect domestic producers of developed countries. Because of this interest, developed countries, particularly the United States, had long refused to address the arbitrary nature of anti-dumping measures or make any changes until recently when developing countries began to apply an increasing number of anti-dumping measures against exports from developed countries. Despite some of the examples above that heightened the requirements for invocation of anti-dumping measures, most FTAs between developed and developing countries fail to eliminate or reduce anti-dumping measures by making their invocations more difficult. The result is that with or without FTAs, developing countries continue to suffer from invocation of anti-dumping measures against their exports while they are obliged to provide market access for exports from developed countries. The same applies to CVD measures. The aforementioned guidelines for FTAs between developed and developing countries should include recommendations to reduce trade remedy measures, including anti-dumping measures that target exports from developing countries. Replacement of anti-dumping measures with competition rules, as exemplified in a few FTAs above, may be considered as an alternative solution to this problem.⁴⁷

E. Dispute Settlement

Dispute settlement procedures are incorporated into many FTAs and BITs.⁴⁸ A peculiar feature of dispute settlement procedures in BITs is that not only state-to-state disputes but also investor-to-state disputes are dealt with. Disputes in which investors challenge states (Host Country governments) are brought before arbitral panels established by the BIT. Generally the following are the major features of dispute settlement procedures in BITs.

1. Procedures in BITs

a. Consultation

Consultation between disputing parties are obligatory and the period of 3-6 months is generally stipulated.

b. Referral to arbitral panel

⁴⁷ It has also been argued that anti-dumping measures should be replaced with safeguards and that the former should be banned. Y.S. Lee, "Toward a More Open Trading System: Should Safeguards Replace Antidumping Measures?", *21st Century Law Review*, Vol. 1, No. 2 (August 2005), 3-14.

⁴⁸ See 2007 Report, *supra* note 27, pp. 85-88.

When a dispute between an investor and the government of the Host Country is not resolved through consultation, the investor can refer the matter to an arbitral panel. In many BITs, there are provisions in which the Host Country has given a consent that it will submit itself to an arbitral panel. Also, in many BITs, an investor can choose either the ICSID rules or UNCITRAL rules as applicable laws and sometimes ICC arbitration rules are provided for applicable laws. Referral to arbitral panel is conditioned on the requirement that the investor does not bring the matter before national courts. Also a claimant is generally prohibited from bringing the matter before domestic courts after an arbitral award has been issued.

c. Remedy

Unlike state-to-state disputes, awards in an investor-to-state dispute usually grant monetary compensation or restitution. An arbitral award is final and binding on the parties. Generally once a dispute is resolved through an arbitral panel, this is final and the claimant is entitled to no further recourse. However, the ICSID Treaty provides for a review and repeal of the award under certain conditions.

2. Procedures in FTAs

Dispute settlement procedures are provided in FTAs. Just as the dispute settlement procedures of the WTO, those in FTAs stipulate consultation among the parties, referral to panel, an award which is binding and that the losing party rectify wrongs and/or provide compensation.

In general, there are three types of dispute settlement procedures in FTAs. The first category is the NAFTA type in which a dispute settlement panel is composed on an *ad hoc* basis when a dispute arises and each Party can bring a claim against the other. All of the dispute settlement procedures in which Japan is a party belong to this type. This type of dispute settlement procedure has been adopted, *inter alia*, in the Korea-Singapore Agreement, the Australia-Singapore Agreement and the Thai-New Zealand Agreement.⁴⁹

The second category is the EU type in which a dispute is referred to a commission or council composed of representatives of the Parties to the FTA and the council or commission renders decisions and issues recommendations. Besides the European Union, some multilateral agreements adopt this category.⁵⁰

The third category is a hybrid of the above two types in which a dispute is referred to a council or commission as in the second category, but the parties can choose to compose a panel as in the first category when the dispute is not resolved through the procedures in the second category. There are many FTAs which adopt this type including the ASEAN and the Andean

⁴⁹ See 2007 Report, *supra* note 27, p. 686.

⁵⁰ See 2007 Report, *supra* note 27, pp. 686-687.

Community.⁵¹

In some areas, subject matters covered by an FTA overlap with those covered by WTO agreements. When disputes arise in such areas, both dispute settlement procedures provided for in the WTO regime and those provided for in the FTA may apply at the same time. When this happens, the question is which agreement prevails. On this issue, dispute settlement procedures provided in an FTA can be divided into three categories: (a) those in which the procedures provided in FTA are given priority, (b) those in which the WTO dispute settlement procedures are given priority and (c) those in which claimants can choose either forum. NAFTA falls under the first category. NAFTA procedures apply when the claimant claims that the subject matter should be judged under environmental rules, SPS rules and TBT rules provided in the NAFTA Agreement. The EC-Chile Agreement falls under the second category in which it is provided that when WTO agreements apply to the subject matter of a dispute, WTO agreements should be given priority. Many dispute settlement procedures incorporated into FTAs, such as those in which Japan is a party, belong to the third category: a party to a dispute can choose either the WTO dispute settlement procedures or those provided for in the FTA, but once a party has chosen one procedure, it cannot resort to other procedures later in time.

Dispute settlement procedures incorporated in BITs can be distinguished from the WTO dispute settlement procedures in that they cover disputes concerning investment in which investors bring claims against a state and, as such, accomplish the result which the WTO is not capable of accomplishing. Likewise dispute settlement procedures incorporated into FTAs are suitable for resolving disputes on subject matters unique to the FTA. Many FTAs today are not only just focused on trade matters but also on investment, movement of persons and many other matters. Disputes on such matters cannot effectively be resolved through the WTO dispute settlement procedures.

However, when disputes arise in the areas covered by WTO agreements and an FTA, the application of the FTA dispute settlement procedures raises a problem with the WTO disciplines. Article 23 of the DSU states “When [WTO] Members seek the redress of a violation of obligations or other nullification or impairment of benefits under the covered agreements or an impediment to the attainment of any objective of the covered agreements, they shall have recourse to, and abide by, the rules and procedures of this Understanding.” The text of that article seems to prohibit recourse to any dispute settlement procedures other than those incorporated into the dispute settlement procedures in the WTO when the subject matter of a dispute is covered by WTO agreements. How can provisions in NAFTA requiring recourse to its dispute settlement procedures under certain circumstances in exclusion of the WTO procedure be reconciled with this WTO requirement? The existence of different dispute settlement procedures between FTAs and the WTO create confusion and uncertainty in the international trade order through forum shopping when the participants of FTAs are also Members of the WTO. In light

⁵¹ See 2007 Report, *supra* note 27, p. 687.

of this, there should arguably be a principle that the WTO dispute settlement procedure should be given priority over those in FTAs when a subject matter is covered by both.

From the perspective of developing countries, the availability of separate dispute settlement procedures in an FTA can be as much a burden as an opportunity to bring up their own claims in a seemingly more neutral forum than national courts. Developed countries, with more resources and better expertise with the dispute settlement procedure, are more likely users of these procedures than their developing country counterparts. Where multiple forums are available as illustrated above, developed countries that have more experience with different kinds of dispute settlement procedures will have even more of an advantage to put forward their claims than relatively inexperienced developing countries. Perhaps this is another reason to give priority to the WTO dispute settlement procedure where subject matters are covered by both WTO and the FTA. The specific dispute settlement procedures in FTAs between developed and developing countries, including investor-state dispute settlement procedures, should not be overly complicated, costly, and time-consuming for developing countries with limited resources and expertise.

The dispute settlement procedures in FTAs may also have certain implications for the development policies that they adopt. For instance, dispute settlement procedures that allow private foreign investors to bring claims against the host state and require the latter to submit to arbitrations may deter state effort to promote policies that are necessary for economic development but may adversely affect the interest of foreign investors, such as placing foreign exchange controls and safeguards in the times of financial crisis where the FTA does not specifically allow them. While the dispute settlement procedures are used to resolve disputes arising from the application and interpretation of an FTA, these procedures should not be used as a systematic deterrence against developing countries which are trying to adopt economic development policies that may have some adverse effect on the trade interest of developed countries and investment interest of their citizens.

V. Conclusion – Should There Be an FTA Network?

The proliferation of FTAs raises a concern, from the perspective of economic development, that the removal of trade barriers may take away the ability of developing countries to use trade-related policies, such as tariff protection authorized under GATT Article XVIII, to protect and develop their domestic industries. On the other hand, those who advocate for FTAs also argue that the improvement of economic efficiency resulting from the removal of trade barriers should contribute to the economic development of developing countries. The impact of FTAs on economic development thus needs to be assessed and systematically monitored, perhaps by the international bodies such as the WTO and UNCTAD, and the study of this impact should facilitate a discussion as to whether the aforementioned UNCTAD principles and the proposed

mandatory development-facilitation clause in Article XXIV will be necessary.

The proliferation of FTAs may also result in the formation of different and sometimes conflicting rules of trade among trading nations. Also, some FTA rules may also conflict with WTO rules. In this respect, it is highly desirable that trading nations establish a mechanism or network in which information on various FTA rules are compiled. Such a network could provide a forum in which representatives of different FTAs regularly meet, exchange information regarding the implementation of such rules and cooperate with each other with a view to prepare for a degree of convergence of such rules. This network may be governmental or non-governmental and, at the initial stage, may engage only in taking stock of different rules. Ultimately this network may develop to present models or patterns of trade rules and seek to harmonize the currently different rules in FTAs.

In this connection, it is noteworthy to mention activities of the International Competition Network (the ICN).⁵² The ICN is a virtual network of government agencies in charge of competition policy and other interested persons. The WTO decided to establish a working group on trade and competition at the 1998 Ministerial Conference in Singapore with the view to draft an agreement to be incorporated in the WTO regime. Due to various reasons including the opposition of developing countries and the United States, the WTO decided in the Hong Kong Ministerial Conference (2005) that this subject would be dropped from the Doha Development Round. Some developing countries took the position that a binding agreement on competition policy in the WTO may hamper them in designing and executing industrial policies or development policies. The United States also opposed for the reason that a consensus which would be achieved by all WTO Members would represent a low common denominator. Meanwhile, Joe Klein (Assistant Attorney General of the United States Justice Department) proposed the creation of an informal network of competition policy enforcement agencies instead of a formal international organization in which officials of competition authorities of different nations, practicing attorneys, representatives of business communities and academics gather together on a regular basis (once in two years) and discuss issues of competition policies. This proposal was accepted by many nations, gathering momentum and was launched in the 2002 Conference of the ICN held in Naples, Italy.

The main feature of the ICN is that this is not an international organization nor has it any permanent seat anywhere. This is a network in which more than 100 nations participate, exchange information and try to iron out practical ways to establish cooperative relationships among them. The ICN is composed of several working groups such as the Merger Working Group, the Cartel Working Groups and the Competition Advocacy Working Group.⁵³ Members of the Groups engage in joint research in the issues of importance, meet regularly and issue

⁵² For details of the history and current activities of the ICN, see Eleanor M. Fox, "Linked-In: Antitrust and the Virtues of a Virtual Network, *The International Lawyer*, Spring 2009, Vol. 43, No 1, pp. 151-174.

⁵³ For details of activities of the ICN, see www.internationalcompetitionnetwork.org/

non-binding recommendations. However, it is expected that participating enforcement agencies respect these recommendations and adopt them in the enforcement of their laws when it is possible. The ICN has been tremendously successful in promoting convergence of competition policies of the participating nations. Its feature is informality and flexibility. It is an independent network separate from international organizations such as the WTO, the OECD and the UNCTAD.

One can envisage that a similar network would be established in which nations having FTAs participate in a FTA network, regularly meet and discuss ways to iron out degrees of convergence among FTAs to the extent possible. If there is secretariat of FTAs, it can participate in it also. Differences of trade rules contained in different FTAs will be discussed and, if there are any inconsistencies among them, there will be discussions as to the reasons for such differences and possible ways to mitigate problems arising from such differences. If one follows the ICN model, there would be no formal organization and nor are there any binding resolutions and regulations. Such a network is a virtual network and its recommendations are hortatory. This network may produce binding regulations in future but, at present, such tight governance is not envisaged nor is it anticipated. It is probably more realistic to establish such a network at this time instead of establishing a formal organization with binding regulations over the participants and aim at virtual convergence of different rules contained in FTAs.

Another question is whether sponsor is necessary or desirable for this network. One can think of the APEC or the ASEAN in East Asia. The WTO can play an important role in organizing such FTA network. The WTO needs a mandate from Members in order to establish a formal organization for monitoring FTAs and converging trade rules in such FTAs. However, even without such mandate, the WTO can engage in coordinating FTA activities.

One idea is to make use of the TPRM (the Trade Policy Review Mechanism) which is Annex 3 of the Marrakesh Agreement. The TPRB (the Trade Policy Review Board) is established based on Annex 3. The TPRB regularly reviews trade policies of WTO Members and when it finds that there are problems in their trade policies, it recommends improvements. Recommendations have no compulsory effect and its recommendations cannot be used in the dispute settlement procedure. But it can be effective in reminding WTO Members of their problems and rectify them.

Mandate G of the TPRM states: “An annual overview of developments in the international trading environment which are having an impact on the multilateral trading system shall also be undertaken by the TPRB”. There may be arguments, both pro and con, as regards the scope of mandate stated in the Mandate G. However, there is no explicit prohibition in Mandate G against the TPRB’s engagement in coordinating FTA activities.

If the TPRB is to engage in such activities, it can collect data on different FTA agreements,

compare them and come up with some model rules in areas such as the rules of origin, point out differences among them and recommend WTO Members participating in FTAs to exercise their best efforts to converge the contents of such rules or reduce differences. The TPRB can review the progress on a regular basis and, after some years, trade rules in different FTAs may be more harmonized.

The WTO needs to open up a new horizon to break through the deadlock in negotiations and the resulting stagnation. It is time for WTO Members to give the WTO a new mission. If this network is successfully developed, it will contribute not only to the convergence of different rules into a meaningful whole but also promote the interest of developing countries. In the frame of such a network, developing countries can present their common interests and concerns associated with FTAs that have been discussed in the preceding sections.

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