

Feasibility of a Free Trade Agreement with US

By

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This Article begins by defining Free Trade Agreement, moves on to justify the need of Pakistan to enter into a Free Trade Agreement with US. Indicates the care and the necessary steps to be taken by the Pakistani Government before finalizing the Agreement. It also gives an idea of the likely implications of these types of Agreements, their effect on global trading system and the possible advantages and disadvantages to Pakistan with respect to the particular Agreement with US.

Since the last decade, trade liberalization and the pursuit of global free trade has undergone a metamorphosis. The political momentum has shifted away from what was seen by some nations as the painstakingly slow process of multilateral tariff negotiations to smaller regional and bilateral arrangements.

Regional Trade Agreements (RTAs) are the agreements whereby members accord preferential treatment to one another in respect to trade barriers. RTAs are not a new means of trade liberalization; historically, whenever multilateral trade negotiations broke down, bilateral and multilateral free trade agreements came to fill the void. Such strategic trade arrangements have enabled many States to move towards freer trade at their own pace, and for their own benefits.

According to their level of integration amongst participating nation-states, RTAs can be described as Preferential Trading Agreements (PTAs), Free Trade Agreement/Area (FTA), Customs Union, Common Market or Economic Union.

Free Trade Agreement (FTA) is a reciprocal arrangement whereby trade barriers (usually tariffs) between participating nations are abolished. However, each member determines its external trade policies against non-FTA members independently. Most commonly, barriers to trade are reduced over time, but in most cases, not all trade is completely free from national barriers. A prominent example of a FTA is the North American Free Trade Agreement (NAFTA).

The last few years have been marked by the explosion of free trade agreements and grassroots opposition to them. Today, unfettered global free trade is no longer considered inevitable. It is a battlefield being contested by governments and transnational corporations on one side, and organized labour, environmentalists, human rights advocates and citizens groups on the other.

Experiences in the past with implementation of Free Trade Area Agreements effectively illustrate how leaders sign regional and international agreements without adequate consultation and assessment at national and local level.

The writing is on the wall that we must reassess these free trade area agreements. We cannot accept that there are no alternatives in the global economic system. To accept the current orthodoxy of free market fundamentalism without question is not only defeatist, it means ignoring and abandoning responsibility for the economic, social and political consequences.

Pakistan has decided on a future of growing integration and insertion in global trade. As part of this strategy, it has been searching for bilateral trade agreements as a necessary and integral part of its development strategy. Pakistan is currently holding talks with many countries and various other international organizations to sign FTA to mutually benefit each other. For the last three years Pakistan has been trying to conclude FTAs with Sri Lanka, Bangladesh, Morocco, Kenya and Indonesia. But so far only a framework for FTA has been signed with Sri Lanka, and technical details on products are still to be drawn up.

Business leaders say that technical details with Sri Lanka are held up because of the bureaucrats involved in the negotiations. India, on the other hand, has signed bilateral FTAs with Sri Lanka and Bangladesh and has virtually isolated Pakistan within the SAARC's regional bloc.

In a recent move, Pakistan has invited United States to initiate the process of negotiating a free trade agreement, and has already been successful in securing the Trade and Investment Framework Agreement (TIFA), which would help move towards an eventual Free Trade Agreement. TIFA a precursor to Free Trade Agreement (FTA) would lead to increase Pakistan's market access to the United States. An increased market access to the United States would have a positive impact on the life of the common man, because it would increase exports, mobilize the economic activity in Pakistan and result in the growth of the GDP in the country.

This possible agreement carries historical importance for the two countries. For Pakistan, it offers an enormous potential of increase in foreign direct investment (FDI), and provides a clear direction for innovative changes in policies to improve the competitiveness of its private sector and the sustainability of its integral development strategy.

The ultimate aim of Pakistan in going for a Free Trade Agreement with US lies in maintaining its position as a trading partner especially with respect to exports in textiles. This is in view of the danger of competition it may face once textile quota regime comes to an end in 2005 integrating it completely into GATT 1994.

Initially, business leaders and technocrats sought additional trade benefits from US within textile export quota regime. However, it is now considered that a broad understanding with the US on certain trade related issues would be more beneficial. On the basis of this understanding, Pakistan and the US incline for a free trade agreement.

However, this particular idea of FTA raises two questions of extraordinary significance for Pakistan's trade policy: one in regard to FTAs vis-à-vis multilateral Free Trade and the other in regard to its contents, specifically in relation to the issue of labor and environmental standards. The first is a policy issue that a world leader in Trade Policy must concern itself with. Pakistan is not Chile, Singapore or Mexico; what Pakistan does matters much more than what each of them or all together do. Pakistan must address the questions raised by proliferating FTAs as they intrude into the world trading system in ever expanding numbers: do we join the stampede or do we seek to halt it using our power. But any FTA not just the likely US-Pakistan FTA raises that question.

Secondly, Pakistan has to be very careful when it comes to incorporating labor and environmental provisions into trade agreements. Unlike the US-Jordan FTA where such provisions were part of the Agreement, Pakistan needs to be following the path of NAFTA which put such provisions into side agreements.

Despite its great advantages, Pakistan's adaptations to the demands and requirements of free trade represent formidable challenges if it wants to assure itself that the resulting benefits from the transformation of its economy reaches the majority of the population. Clear and transparent discussions of the economic, social, labor and environmental implications of free trade will maximize the possibilities for its success in free trade agreements and will be critical to gain political support, as much in the country, as for trade partners. An important role is required to be played in assuring that the free trade agreements are developed taking into account the region's long-term interests, as well as supporting the economic sectors affected in the adaptation of changes resulting from this major trade opening, and strengthening the skills of the high potential sectors.

Public comments about the negotiation of this free trade agreement need to be invited particularly on the following areas: First area to be considered is economic costs and benefits to Pakistani producers and consumers, especially after the removal of all tariff barriers to trade between the two members countries. The appropriate time for elimination of tariff needs to be given proper consideration. Second one is the non-tariff barrier, especially the one to trade in goods between Pakistan and the United States. The economic costs and benefits to Pakistan producers and consumers of removing those barriers are worth pondering. Then, come the restrictions on investment flows, the costs and benefits to U.S. and Pakistani investors and consumers of eliminating any restriction.

The Pakistani business community and the Government of Pakistan are eager to encourage exports of goods and services to the United States and attract foreign direct investment (FDI) and its accompanying technological transfer. It is hoped that the Government of Pakistan has planned a series of economic impact assessments and awareness campaigns aimed at the educating the business community on the likely U.S.-Pakistan FTA. The objective of this exercise must be to review the U.S.-Pakistan FTA and assess its impact on trade in goods and services with a view to examining the following specific areas:

- (1) The comparative advantage of Pakistan in exports of goods and services to the U.S. market, relative to other countries.

- (2) The effect of FTA-related tariffs, rules of origin, and other market access conditions on Pakistani exporting companies.
- (3) The impact of the FTA on the bilateral trade in services between Pakistan and the United States.

In the context of the likely U.S.- Pakistan FTA, the central indicator of Pakistan's ability to shift its comparative advantage is the degree of trade compatibility between its export structure and that of the United States. Having established compatibility of traded products, Pakistan can then invoke performance indicators to reveal the extent to which firms compete effectively in world and regional market. Success in export markets – measured by rapidly expanding exports and rising market shares – indicates the extent to which an economy is willing and able to achieve global integration and alter its comparative advantage in the global marketplace.

Other matter that is relevant to likely U.S.- Pakistan Free Trade Agreement, includes any measure, policy, or practice of the Government of Pakistan that should be addressed in the negotiations. The possible effects on basic workers' rights, working conditions, and living standards, as well as the possible environmental effects need to be considered.

Before moving into an era of FTA's, it is important that Pakistan has a clear idea of the possible advantages and disadvantages that FTA's have in store.

Free Trade Agreements are two-faced: they lower barriers for members, not for non-members. So, they increase the handicap faced by non-members vis-à-vis members in the markets of FTA members. So, FTAs constitute freer trade for members, greater protection for non-members. They are therefore not identical with free trade.

The spread of FTAs has given rise to concerns that such selective trade arrangements will undermine the benefits of global tariff reform and entrench trading blocs rather than free trade. FTA is beneficial to its member countries in the following aspects:

1. By lowering or eliminating tariffs among themselves, the FTA member countries can enjoy lower importing price and thus increase their overall trade. Due to the trade diversion resulting from the relative lower price, some member countries can increase their imports on goods previously supplied by countries outside the FTA.
2. In addition, FTAs can join the international trade negotiations as a whole. Thus, joining in a FTA will enhance the member countries' bargaining power in multilateral negotiations because of the enlarged size of the negotiator.

There has been growing debate about whether bilateral trade agreements are damaging multilateral efforts to eliminate barriers to international trade. Studies show

that trading blocs always charge optimal tariffs and make trade agreements based on strategic considerations.

If trading blocs are of roughly equivalent size then bilateral trade agreements allow groups of trading blocs to more effectively monopolize world trade in which case they may make free trade less likely. These results suggest that a policy that inhibits the formation of trading blocs may be harmful.

However, not allowing bilateral agreements can result in more protection and lower world welfare. Whether the ban on bilateral agreements helps or not depends on the size distribution of trading blocs. One finds that Free Trade Areas constitute a potential threat to the world trading system because these types of agreements are, in general, trade diverting and they lead to formation of new interest groups who oppose the multilateral tariff reductions.

However others say that free trade agreements might provide trading blocs with stronger incentives to pursue multilateral trade liberalization since establishing these types of agreements allows small countries to more effectively deal with large trading blocs.

Studies of economies have shown that when trade agreements lead to trading blocs of equal size they tend to be welfare enhancing. If they lead to blocs of unequal size then the opposite occurs.

For Pakistan, to assess the potential impact of free trade agreement (FTA) with United States, it can take the example of NAFTA (North American Free Trade Agreement) set up by the United States of America, Canada and Mexico. Under the NAFTA agreement for example, corporations can sue a country if it is deemed to obstruct free trade. For example, Canada's attempt to protect its citizen's health from the effects of a fuel additive was overturned and deemed as an obstruction to free trade. Subsequently, Canada was sued by a US chemical manufacturing corporation that produced this additive.

Free Trade Agreements with United States as a party have been subject to heavy criticism. For instance, some of the attempts and conditions suggested by USA in an effort to improve trade relationships and agreements with Africa have been criticized by South Africa and various NGOs as being "too much in favor of multinational corporations and foreign investors at the expense of the vast number of poor Africans."

The US-Vietnam trade deal that was struck in the summer of 2000, was also about more economic liberalization of capital flows in and out of Vietnam (one of the things the US wanted to achieve in its war with that nation). US corporations stand to benefit.

Another concern is that greater reliance on a bilateral or regional approach to trade liberalization may undermine and supplant, instead of support and complement, the multilateral GATT approach. Hence, the long-term result of bilateralism could be a deterioration of the world trading system into competing, discriminatory regional trading blocs, thereby stifling world trade. Just such a disastrous experience in the

thirties prompted the creation of the current multilateral trading system and makes its repair and refurbishment today an urgent task.

While structural adjustment programs create labor market and other economic conditions favorable to the transnational corporations, today's free trade agreements create a global legal system that puts these corporations' interests above the rights of citizens. These agreements are designed to ensure that transnational companies are the ultimate determiners of all that happens on the planet; that they need not answer to citizens anywhere. It leaves people to question the meaning of democracy in the age of global corporate dominance.

Essentially, FTAs are violations to WTO's non-discrimination principle. This basic principle is defined in the Most-Favored-Nation (MFN) rule, which requires a member country to extend to all WTO members the privileges that it grants to one contracting party. However, WTO views FTAs to be good and encourages the formation of free trade areas and customs union.

To ensure that FTAs can improve regional trade liberalization without hurting global trade liberalization, Article 24 of GATT regulates that FTAs should trade more freely among their member countries without raising barriers on trade towards the outside world. In addition, the WTO General Council has a Committee on Regional Trade Agreements (CRTA). Its purpose is to examine regional groups and to assess whether they are consistent with WTO rules.

Those who favour FTAs say that they are in fact helpful to world trade liberalization. Compared with multilateral negotiation systems, smaller numbers of parties are involved in FTAs. Their similar political and economical interests can be easily processed. FTA rules can pave the way for enhanced WTO multilateral negotiations.

But according to studies conducted by the World Bank, reciprocity is important in regional trade agreements and the value of reciprocity in regional agreements is less clear. Unlike in multilateral negotiations, where reciprocity enhances overall trade liberalization reciprocity in regional agreements furthers discriminatory tariff reduction.

There is evidence that large countries extract greater trade concessions from small countries. A large increase in access to the developing-country market like Pakistan would lead to only a small increase in access to the rich-country market of United States.

Reciprocity can be especially damaging in Free Trade Agreements, where asymmetries in size suggest that low-income countries will have to make relatively larger trade concessions to achieve an agreement with a high-income country. A need for reciprocity also implies that some agreements should be infeasible; for example, a large country would gain too little from a free trade agreement with a very small low-tariff country to make the agreement worthwhile. Finally, reciprocity could provide incentives for low-income countries to maintain higher trade barriers in order to obtain preferences from high-income countries, and as a result generate greater trade diversion.

While seeing the picture from the US perspective, the FTA negotiators have made no attempt to place workers' rights, human rights, or environmental standards on the agenda. People in US have been pointing out that the above are basic components of society that should be considered for any nation with which we pursue free trade agreements, and yet Pakistan is a country that has not made significant strides in any of these areas. Moreover, they think that a free trade agreement with Pakistan can cause a potentially damaging effect on a struggling U.S. economy. They compare it with NAFTA that has costed U.S. citizens nearly 800,000 jobs.

Finally, the three possible ramifications of FTA on US and Pakistan are likely to be: First, the FTA will open many opportunities for Pakistan to expand its exports to the U.S. market. The greatest opportunities will occur in the emerging export products that have the highest degree of trade compatibility with the United States.

Second, U.S. exports to Pakistan are expected to grow substantially as a result of the FTA. Since there is a large amount of two-way trade in many traded products, the elimination of trade barriers between Pakistan and the United States will favor the most efficient producers. In Pakistan, inefficient industries with particularly high levels of protection will be most vulnerable, and the FTA will liberate valuable resources from less productive sectors for use in Pakistan's true comparative advantage industries.

Third, there are expectations about the FTA effects on services trade of both US and Pakistan. The FTA is likely to open more new opportunities for U.S. businesses in Pakistan and for Pakistani businesses in the United States.

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