

# **RTA's and the WTO**

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## **I. Introduction**

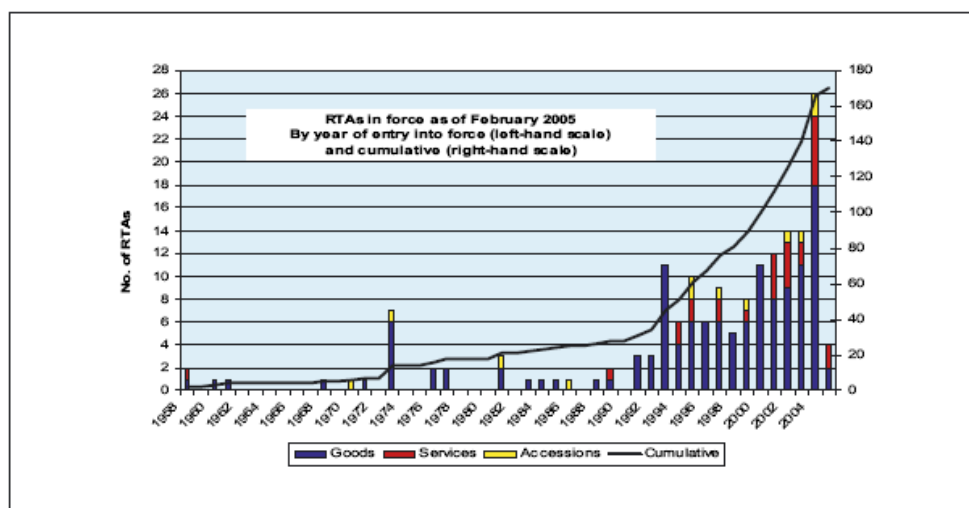
Regional Trade Agreements (RTAs) have become an integral feature of today's international trading system. Their proliferation in the past decade has led to the prominence of such agreements in recent trade discussions, thereby making the topic a very pertinent one to discuss. However, in order to deepen the debate, one should first explore the degrees of integration of RTAs. The main types include Free Trade Areas (FTAs), Customs Unions, Common Markets, and Economic Unions. While exploring these trade tools, an interesting question emerges: which method is best suited to achieving the generally agreed upon maxim of Free Trade? The most recent trend is the movement to ever greater economic integration, as in the EU. Nevertheless, the United States, the world's largest economy, seems to prefer a network of FTAs. The resulting conflict of views has spurred a worldwide debate on the matter, one likely not to be settled without difficulty.

## **II. Proliferation of Regional Trade Agreements and worldwide trend towards more deeply integrated Trading Blocs**

As previously stated, vast numbers of RTAs have been emerging in the last ten years. This trend is still accelerating even today. "Between January 2004 and February 2005 alone, 43 RTAs have been notified to the WTO, making this the most prolific RTA

period in recorded history.”<sup>1</sup> Indeed the overall tendency in the world is to favor one kind of RTA or another. The number of these agreements in force is 170, while many more are under negotiation.<sup>2</sup> It must be mentioned, though, that the intensification of the agreements has occurred particularly strongly in the West and the Asia-Pacific region.

*Notified RTAs to the GATT/WTO (1948-2005)*<sup>3</sup>



At first glance, these types of agreements appear counter productive to the WTO’s principle of Most Favored Nation (MFN), as applied to lowering trade barriers evenly and indiscriminately. The idea was to spread out this principle and presumably build a world of free trade based off of it. RTAs on the other hand, represent a clear kind of Trade Bloc, with the inherent notion of discrimination. Notwithstanding, “RTAs are being embraced by many WTO Members as trade policy instruments and, in the best of

<sup>1</sup> Jo-Ann Crawford and Roberto V. Fiorentino, *The Changing Landscape of Regional Trade Agreement*, ([http://www.wto.org/english/res\\_e/booksp\\_e/discussion\\_papers8\\_e.pdf](http://www.wto.org/english/res_e/booksp_e/discussion_papers8_e.pdf), WTO: 2005), 1.

<sup>2</sup> World Trade Organization, *List of RTAs notified to the GATT/WTO*, ([http://www.wto.org/english/tratop\\_e/region\\_e/region\\_e.htm](http://www.wto.org/english/tratop_e/region_e/region_e.htm), WTO: 2005).

<sup>3</sup> Jo-Ann Crawford and Roberto V. Fiorentino, *The Changing Landscape of Regional Trade Agreement*, ([http://www.wto.org/english/res\\_e/booksp\\_e/discussion\\_papers8\\_e.pdf](http://www.wto.org/english/res_e/booksp_e/discussion_papers8_e.pdf), WTO: 2005), 2.

cases, as complementary to MFN.”<sup>4</sup> However, this sentiment is not universal, and while there may be benefits to RTAs there are also plenty of challenges involved.

The promotion of free trade at a preferential level may help developing economies to implement domestic reforms and open up to competitive market pressures at a sustainable pace, thus facilitating their integration in the world economy. This may also benefit the multilateral process by exerting leverage for openness and competitive liberalization in international trade relations. Yet, the development of complex networks of non-MFN trade relations and of regulatory regimes which increasingly touch upon policy areas uncharted by multilateral trade agreements may place developing countries, in particular, in a weaker position than under the multilateral framework. As for the multilateral trading system, such RTA proliferation is already undermining transparency and predictability in international trade relations, which are pillars of the WTO system. This may ultimately alter global trade patterns with severe implications for WTO Members through, among others, trade and investment diversion and diminished attention to the multilateral system.<sup>5</sup>

As is evident, the future implications of the movement towards RTAs are as of yet unknown; they may be ultimately a very destructive element against the push for free trade or they may be the key to resolving the matter.

In regards to the types of RTAs that we observe in the real world, the most proliferated is by far the FTA, occupying 84 percent of the RTAs in force today. An FTA itself is an

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<sup>4</sup> Jo-Ann Crawford and Roberto V. Fiorentino, 1.

<sup>5</sup> Jo-Ann Crawford and Roberto V. Fiorentino.

agreement under which the member nations remove all trade barriers between themselves, while maintaining individual national barriers in respect to the rest of the world (for example, NAFTA). The next type of RTA is the Customs Union, coming in at 8 percent of the current agreements. This arrangement follows the same principles as an FTA, but indeed eliminated differences in national barriers. There is only one common set of trade barriers applied to non-members of the Customs Union (i.e., MERCOSUR). The next two important classifications of RTAs are common market and economic union. A common market is essentially a Customs Union, with the added stipulation of freedom of factor flows. An Economic Union entails full economic integration (the closest example of which is the EU, although it is not yet entirely integrated). Obviously, the percentage of active agreements falling under either of these categories is negligible, but their percentage of trade flows is quite significant. “The predominance of FTAs over Customs Unions [Common Markets and Economic Unions included] is probably due to the fact that they are faster to conclude and require a lower degree of policy coordination among the parties since in an FTA each party maintains its own trade policy vis-à-vis third parties.”<sup>6</sup> The easiness of an FTA is inherent in its makeup, and the benefits seem to clearly outweigh the hassles of negotiating such an agreement. “Customs Unions, on the other hand, require the establishment of a common external tariff and harmonization of external trade policies, implying a greater loss of autonomy over the parties’ commercial policies and longer and more complex negotiations and implementation periods.”<sup>7</sup> This has serious repercussions in regards to a nation’s sovereignty. The inevitable question is what policies are under the jurisdiction of the Customs Union, and which policies are in

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<sup>6</sup> Jo-Ann Crawford and Roberto V. Fiorentino, 4.

<sup>7</sup> Jo-Ann Crawford and Roberto V. Fiorentino.

the realm of the national government? Obviously, ground rules are determined on a case by case basis, nonetheless, this is an insight into the complicated nature of Custom Union agreements. “Furthermore, the majority of FTAs are concerned with strategic market access, often unbound by geographical considerations; in Customs Unions, on the other hand, geographical considerations play a pivotal role in defining the objective of economic (and often political) integration among the parties concerned.”<sup>8</sup>

Nevertheless, deeper integration beyond FTAs has garnered extensive media coverage in recent years, especially where concerning the European Union. While originally established as a Customs Union by the Treaty of Rome in 1957 (stemming from the trade of the prime materials coal and steel), it has since become a much more deeply integrated Union. All monetary and trade policy of the members is determined by a representative governing council (involving multiple organs, including the Council of the European Union, the European Commission, the European Parliament and the European Court of Justice). This leaves the fiscal policy up to the individual nation, however it is easy to imagine a situation involving fiscal policy counter acting monetary policy, especially where the two do not coincide in final aims. Regardless, beyond these policies, the EU shares also a common currency and common borders.

An even more obvious, but often overlooked fully integrated Economic Union is the case of the United Kingdom. The independent nations of England, Scotland, Wales, and Northern Ireland operate under the economic policies dictated by the supranational

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<sup>8</sup> Jo-Ann Crawford and Roberto V. Fiorentino.

organizational structure of the UK.<sup>9</sup> In other words, it is not fair to fully disregard the possibility of a completely integrated European Union; however, the completion of the integration would appear to be fairly far into the future.

As a final example, we present an African Customs Union, namely The Southern African Customs Union. Its organization is a bit peculiar, nevertheless, worth examining. The five members are Botswana, Lesotho, Namibia, South Africa, and Swaziland. The dominant member, South Africa, collects levies from customs, sales, and excise duties for all five members, sharing out proceeds based on each country's portion of imports.<sup>10</sup>

The future of RTAs seems to be an interesting combination of the ideas of a bilateral agreement based upon plurilateral agreements. “A noteworthy development expected in the next five years, which reflects the growing consolidation of established trading relationships, is the emergence of a new category of agreement, namely RTAs where each party is a distinct RTA itself.”<sup>11</sup> This may in fact be evidence towards the assertion of some WTO Members that RTAs do indeed enhance the progression towards international free trade. We must keep in mind however, that “the fact that several such RTAs have been under negotiation for some time, but that none, thus far, has been concluded suggests that such RTAs are complex to negotiate.”<sup>12</sup> Again, the suggestion is that such high hopes as free trade are not reasonably expected for a long time to come. Nevertheless, the possibility does not seem negated.

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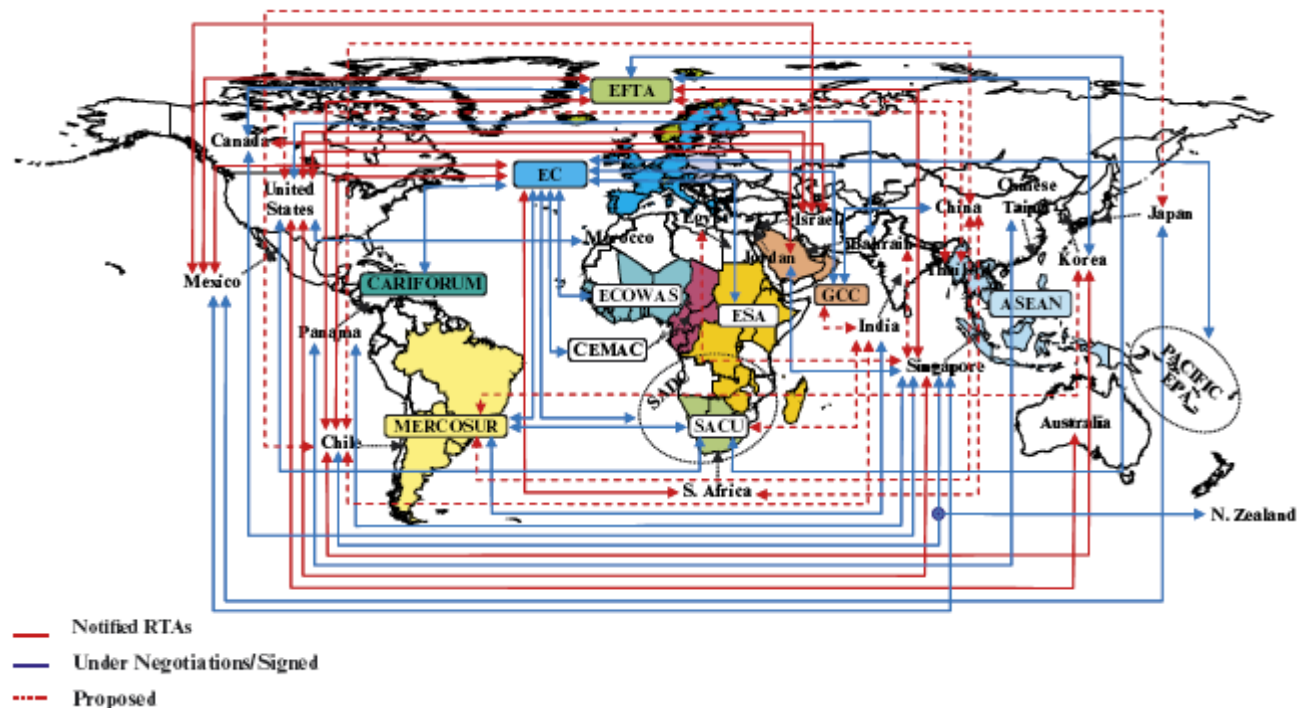
<sup>9</sup> [http://en.wikipedia.org/wiki/Complete\\_economic\\_integration](http://en.wikipedia.org/wiki/Complete_economic_integration), Wikipedia: 2005.

<sup>10</sup> [http://en.wikipedia.org/wiki/Southern\\_African\\_Customs\\_Union](http://en.wikipedia.org/wiki/Southern_African_Customs_Union), Wikipedia: 2005.

<sup>11</sup> Jo-Ann Crawford and Roberto V. Fiorentino, *The Changing Landscape of Regional Trade Agreement*, ([http://www.wto.org/english/res\\_e/booksp\\_e/discussion\\_papers8\\_e.pdf](http://www.wto.org/english/res_e/booksp_e/discussion_papers8_e.pdf), WTO: 2005), 4.

<sup>12</sup> Jo-Ann Crawford and Roberto V. Fiorentino, 5.

*Cross Regional RTAs as of February 2005*



### III. Limitations of Trade Blocs

Trade blocs, free trade areas, and bilateral agreements are emerging far and wide in international trade. In 2001, regional trade agreements (RTAs) accounted for 43% of world trade, and the rate was expected to reach 55% by the year 2005. The emergence of RTAs has added diversity and complexity thereby creating a web in international trade relations<sup>13</sup>. Growth in trade is observed as a result of these negotiations, but are they really the best method of liberalizing trade on a global level? The rapid surfacing of RTAs evokes concerns for the future of free trade, and in general the welfare of the world economy in the long run. There are six dominant concerns involving the efficiency and

<sup>13</sup> Heydon, Kenneth. "Making the Global Market Work." *The OECD Observer* Sept. 2001: (27-31)

appropriateness of regional and bilateral agreements and their effects on international trade.

### *Trade Diversion*

Efficiency is a great concern surrounding the creation of trade blocs. Trade diversions can be the unfortunate effect of these preferential trade agreements. Trade diversions are created when trade barriers are lowered in a bloc or region, thus making prices on imports from outsiders comparatively higher, even if they are the low-cost supplier. Trade is then diverted away from the low-cost supplier, to the less efficient incumbent. These breaches in efficiency have welfare effects.

### *“Competitive Regionalism”, Costly Negotiation Process and Overlapping Agreements*

Establishment of regional trade agreements has gained momentum. Small countries in particular are vulnerable to pressures to join trade blocs in order not to be left out of benefits from increased trade volume. This tendency is referred to as “competitive regionalism.” The pressure to quickly regionalize may also distract efforts from the greater goal of multilateral liberalization of trade. Since the pace of multilateral talks is generally slow (the Uruguay Round took seven years) requiring extensive negotiations; countries that would prefer liberalization of trade on a multilateral level are, in the mean time, scrambling to regionalize. Furthermore, the negotiation process is costly, particularly to smaller countries, and given the “cost of non-participation” in RTAs, efforts are concentrated on quick regional agreements. Given the pressures to regionalize, and limited negotiation resources, countries may hastily create trade blocs. This

“competitive regionalism” can ultimately divert efforts away from greater free trade, and rather create complex barriers among blocs.

The rapid creation of regional agreements may also hinder the greater goal of free trade by creating a complex web of agreements, thus posing a challenge to and complicating multilateral solutions through the WTO. Agreements with too much red tape can initially look attractive, but if not in harmony with greater global negotiations; the participants can find themselves at a disadvantage in the future. In this light, it is warned that the benefits given by the preferential treatment through regionalization, may be short lived, and unable to exceed the costs of continuous administration of the bloc.

*Preferential Liberalization Can Potentially Increase Vulnerability*

Entering into a trade bloc makes all parties vulnerable to the decisions and practices of all countries involved. For political or other reasons an incumbent of the region may revoke or modify the preferential treatment granted by the agreement. This situation is particularly dangerous when there is a dominant trade partner in the bloc that may shift its weight around for political gains. Furthermore, the preferential agreement may shelter industries and hamper inefficiencies within the bloc. In the case that the bloc should expand, or the terms of the agreement change, the margins of preference are eroded, and the countries are worse off. A more stable system would be multilateral reduction of barriers within a common set of rules<sup>14</sup>.

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<sup>14</sup> Hilaire, Alvin and Yongzheng Yang. The United States and the New Regionalism/Bilateralism. IMF Working Paper, Oct. 2003, 8

*Inclusion of Additional Elements in RTAs*

It is common for RTAs to include elements unrelated to trade, that may in fact serve to restrict trade rather than promote trade in the long run. RTAs, especially many involving the US, oftentimes contain parameters on labor standards, environmental issues, intellectual property rights, and capital movements<sup>15</sup>. In some cases noncompliance with the agreed parameters results in trade sanctions or other forms of punishment. These types of standards could be detrimental to trade growth especially for countries in which institutions are weak.

**IV. The Multilateral Alternative**

There is a consensus in the realm of economists that multilateral, free-trade would be the ideal global trade system. This system would imply a level playing field for all countries. The World Trade Organization emphasizes the multilateral approach to free trade and opposes trade discrimination in principle. Trade blocs, in their various forms, present a challenge to the central principle of the WTO; the Most Favored Nation (MFN) clause.

With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favorable than that it accords to like services and service suppliers of any other country.<sup>16</sup>

Note qualifications to the MFN rule via Art. 2 exemptions and RTAs (Art.5)

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<sup>15</sup> Hil, 8

<sup>16</sup> [www.WTO.org](http://www.WTO.org)

There are exceptions to this rule that involve considerations for developing nations and an ambiguous clause for industrialized countries in trading blocs. This loophole allows the creation of trade blocks that reduce barriers for members, as long as they do not original barriers against outsiders remain unchanged. This allows blocs to comparatively affect trade, and thus create advantages for the blocs.

Many advocates of free trade agreements through regionalism suggest that the competitive establishment of trade blocs is a stepping stone to a multilateral free trade regime because they foster market openness and structural reform. Furthermore, any contribution to free trade has the effects of expanding markets, providing access to economies of scale, establishing integration among member countries and creating trade relationships. They point to the North Atlantic Free Trade Agreement (NAFTA) as a catalyst of the Uruguay Round because it pioneered free trade areas and served as an example in which further negotiations in free trade could begin. RTAs are also seen as an impediment to multilateral free trade liberalization because their creation and maintenance distract resources away from global free trade initiatives. Indeed, it has been evident at the Doha Round that the focus and trend in regionalization has decreased incentives for multilateral negotiations<sup>17</sup>. The challenge to decipher RTAs as building blocks or stumbling blocks is a challenge for the World Trade Organization's committee on Regional Trade Agreements. The challenge to international trade and those in the true pursuit of free trade is to make meaningful progress on a multilateral level that surpasses the short term gains that countries are seeking from joining these trade blocs.

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<sup>17</sup> Hil, 3

## V. US Trade Policy

The United States is in a position of influence in the international trade arena due to the size of its markets and position as a leader. Therefore the policies of the US can set the tone for trade arrangements on a global scale. Traditionally, the US has emphasized multilateral trade liberalization as the best path for development of global trade and worldwide stability. Moreover, the US' policy seeks to lower trade barriers within a common set of rules without discrimination. However, the extent of US bilateral trade negotiations (they used the term "Free Trade Area") suggest a "new regionalization"<sup>18</sup>. The policy of the US still favors the multilateral approach at the core, but regionalism has been observed in US trade policy. The US' first free trade agreement (FTA) was a bilateral agreement between the US and Israel and it went into effect Sept 1, 1985. The more popular, NAFTA was created only 5 years later and the trend has continued (c.f. appendix 1.)<sup>19</sup>

It is evident that the conflict between regional and multilateral trade agreements is not resolved in US policy. Hilaire and Yang of the International Monetary Fund assert that US international trade policy is "running along three parallel tracks." The first is the traditional aim of lowering tariffs on imports from developing nations without reduction in tariffs imposed by the exporting entity. The second track would be characterized the traditional multilateral proposals underway through the World Trade Organization at the Doha Round. The final track is development of free trade agreements (regionalization) that has gained increasing momentum.

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<sup>18</sup> Hil, 3

<sup>19</sup> Congressional Budget Office, The Pros and Cons of Pursuing Free-Trade Agreements: Economic and Budget Issue Brief 2003.

This tri-path approach can be better understood in the scope of the overall trade policy goals. The US' primary goals for international trade are: increasing exports of goods and services, enhancing investment climate abroad, and cementing geopolitical and security links<sup>20</sup>. These goals reveal the complexities of the trade environment. The forces at play in trade negotiations are not purely economic. In order to realize political objectives the US can use its formidable influence as the world's greatest market. FTAs are an effective way to make progress in free trade liberalization, yet at the same time maintain the control of the geopolitical environment through. This is, as discussed earlier, not the most efficient trade system because diversions can surface, yet this is not a great concern for the US because these diversions are in general not significant given the volume of US trade. However, from the point of view of the other countries involved, these diversions could have real effects on welfare, and limit growth opportunities for these economies.

US trade blocs have productive and counterproductive components when assessing their overall contribution to free trade. Most recent US FTAs include provisions for the environment, labor standards, intellectual property rights and capital movements in the trade treaties. Although these measures can be seen as positive, they are indeed forms of barriers to free trade, especially if nonperformance entails trade sanctions. US free trade agreements also contribute positively to multilateral free trade in the sense that they have large spans, such as hemisphere wide rules proposed in the Free Trade Area of

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<sup>20</sup> Ebrahim-zadeh, Christing. IMF Survey: "Regional and Bilateral Agreements Should be Pursued with Caution." Interview with authors Hilaire and Yang. June 24, 2005

The Americas (FTAA) for many of their enforced provisions including intellectual property rights, subsidies, antidumping, investment, competition policies and more. Furthermore, US negotiations of FTAs include timetables for established removal of all trade restrictions on manufactured goods, agriculture and services<sup>21</sup>. (example FTAA: Free Trade Area of the Americas proposal)

## **VI. Conclusion: Regional and Bilateral Trade Schemes Should be Pursued with Caution**

Regional trade blocs are a reality for international trade, it is important that these arrangements coincide with multilateral efforts and do not create an international trade scene dominated by great rivaling regional blocks centered around the United States, the European Union (EU) and Japan<sup>22</sup>. Regional trade agreements that offer the greatest benefits and the least amount of diversion should be pursued. RTA's that would contribute to greater trade liberalization would strive to maintain relatively low external barriers and minimize trade diversions. Characteristics of "good" RTAs would include: diverse regional coverage, comprehensive coverage of products, and broader reform agendas appropriate for development level.

Not all trade blocks are equal. The WTO's task of ensuring RTA creation that is in accordance to the most favored nation clause and promotes greater trade liberalization is complicated given the web of regional trade agreements. Until there is a greater emphasis by nations to pursue free trade multilaterally, the negotiations such as the Doha

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<sup>21</sup> Hil, 10

<sup>22</sup> CBO, 4

Round, will drag on in the midst of emerging trade blocks. In order for these blocs not to be counterproductive, they must not undermine multilateral liberalization, and avoid using trade remedies as protectionist instruments.

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## Appendix 1:

Table 1.

## U.S. Trade in 2002 with Countries of Current and Proposed Free-Trade Agreements

	U.S. Exports to Country in Billions of Dollars	U.S. Imports from Country in Billions of Dollars	U.S. Exports to Country as a Percentage of Total U.S. Exports	U.S. Imports from Country as a Percentage of Total U.S. Imports
<b>Agreements Already Implemented</b>				
U.S.-Israeli Free Trade Agreement	5.3	12.4	0.8	1.1
U.S.-Canadian Free Trade Agreement	142.5	210.5	22.6	18.2
North American Free Trade Agreement (Mexico only, excluding Canada)	86.1	134.1	13.7	11.6
U.S.-Jordanian Free Trade Agreement	0.4	0.4	*	*
<b>Agreements Negotiated but Not Yet Ratified</b>				
U.S.-Singaporean Free Trade Agreement	14.7	14.1	2.3	1.2
U.S.-Chilean Free Trade Agreement	2.3	3.6	0.4	0.3
<b>Agreements Under Negotiation or for Which Intention to Negotiate Has Been Announced</b>				
U.S.-Central American Free Trade Agreement				
Costa Rica	2.9	3.1	0.5	0.3
El Salvador	1.6	2.0	0.3	0.2
Guatemala	2.0	2.8	0.3	0.2

Honduras	2.5	3.3	0.4	0.3
Nicaragua	<u>0.4</u>	<u>0.7</u>	<u>*</u>	<u>*</u>
Subtotal	9.4	11.8	1.5	1.0

Free Trade Area of the Americas  
(Excluding Canada, Mexico, Chile,  
and Central America)

Antigua and Barbuda	*	*	*	*
Argentina	1.5	3.2	0.2	0.3
Bahamas	0.9	0.5	0.1	*
Barbados	0.2	*	*	*
Belize	0.1	*	*	*
Bolivia	0.2	0.2	*	*
Brazil	11.2	15.6	1.8	1.4
Colombia	3.3	5.4	0.5	0.5
Dominica	*	*	*	*
Dominican Republic	4.1	4.2	0.7	0.4
Ecuador	1.5	2.1	0.2	0.2
Grenada	*	*	*	*
Guyana	0.1	0.1	*	*
Haiti	0.6	0.3	*	*
Jamaica	1.4	0.4	0.2	*
Panama	1.3	0.3	0.2	*
Paraguay	0.4	*	*	*
Peru	1.4	2.0	0.2	0.2
St Kitts-Nevis	*	*	*	*
St Lucia	*	*	*	*
St Vincent and Grenadines	*	*	*	*
Suriname	0.1	0.1	*	*
Trinidad and Tobago	1.0	2.4	0.2	0.2
Uruguay	0.2	0.2	*	*
Venezuela	<u>4.1</u>	<u>14.4</u>	<u>0.7</u>	<u>1.2</u>
Subtotal	34.1	51.4	5.4	4.5

U.S.-Southern African Customs Union  
Free Trade Agreement

Botswana	*	*	*	*
Lesotho	*	0.3	*	*
Namibia	*	*	*	*
South Africa	2.4	4.2	0.4	0.4
Swaziland	<u>*</u>	<u>0.1</u>	<u>*</u>	<u>*</u>
Subtotal	2.5	4.8	0.4	0.4
U.S.-Australian Free Trade Agreement	12.3	6.4	2.0	0.6
U.S.-Moroccan Free Trade Agreement	0.6	0.4	*	*
U.S.-Bahraini Free Trade Agreement	0.4	0.4	*	*

### All Current and Proposed Free-Trade Agreements

<b>Total Trade for All of the Above</b>	<b>310.7</b>	<b>450.4</b>	<b>49.4</b>	<b>39.0</b>
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Source: Congressional Budget Office based on trade data from the U.S. Bureau of the Census.

Notes: The numbers for exports are free-alongside-ship values, and the numbers for imports are customs values. Numbers may not add up to totals because of rounding.

\* = less than \$0.1 billion or 0.1 percent.

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