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# Integration of Markets vs. Integration by Agreements

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## Abstract

This paper provides an analysis of the two channels of regional integration: integration via markets and integration via agreements. Given that East Asia and Latin America are two fertile regions where both forms of integrations have taken place, the authors examine the experiences of these two areas. There are four related results. First, East Asia had been integrating via markets long before formal agreements were in vogue in the region. Latin America, by contrast, has primarily used formal regional trade treaties as the main channel of integration. Second, despite the relative lack of formal

regional trade treaties until recently, East Asia is more integrated among itself than Latin America. Third, from a purely economic and trade standpoint, the proper sequence of integrations seems to be first integrating via markets and subsequently via formal regional trade agreements. Fourth, regional trade agreements often serve multiple constituents. The reason why integrating via markets first can be helpful is because this can give stronger political bargaining power to the outward-looking economic-oriented forces within the country.

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# **Integration of Markets vs. Integration by Agreements**

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## 1. Introduction

During the last decade, we witnessed a major transformation in the global governance of international trade relationships. The first development occurred in 1995 with the creation of the World Trade Organization (WTO), which is the foremost global institution governing the conduct of international trade. Rules contained in the Uruguay Round which created the World Trade Organization are the most ambitious and comprehensive multilateral trade laws ever ratified by member countries and they provide an anchor and a set of norms for all contracting parties. Paradoxically, parallel to the development of these multilateral rules since 1995 is the second major development in international trade relationships—the proliferation of bilateral, regional and other preferential trade agreements among nations. As the Doha Round of negotiations is currently indefinitely suspended, it is expected that regional and bilateral trade deals will become even more prevalent.

The creation of Preferential Trade Agreements (PTAs) such as Free Trade Areas (FTAs) is by no means new. But the sheer number and the speed with which these agreements have been negotiated in the past ten years are simply astonishing. By 2005, all but one WTO member was trading under one or more PTAs (Limao 2005). In this paper, we would like to analyze the recent history, characteristics and the political economy of regional and bilateral trade integration from the viewpoint of two core concepts: *integration of markets vs. integration by agreements*.

As its name suggests, the concept of *integration of markets* focuses on the idea that economies can integrate among themselves through the use of the marketplace, i.e. allowing the private sector to be the vanguard of trade integration. This can also be described as regional integration via *de facto* agreements. More concretely, this means that the economies in a region trade intensively among themselves without explicit formal preferential trade agreements. To facilitate intra-regional trade without the help of regional legal trade agreements, some of the economies may pursue policies of unilateral domestic deregulation and trade liberalizations, while others may improve their infrastructure (such as ports and highways), streamline their custom procedures or pursue policies that may facilitate inward foreign direct investment. In other words, even integration via the markets can entail the use of some business-friendly policies by individual economies, even though no legal regional trade treaties are signed by governments.

The second core concept is *integration by agreements*, which focuses on trade integration via the use of formal or *de jure* trade treaties. This channel of integration emphasizes the primacy of legal instruments to further economic integration among countries. There is no doubt that these two instruments of integration are very much related and indeed ultimately they are *complementary*. Integration of neighboring markets without formal regional trade agreements can create uncertainty among businesses since the institutional foundations may not be sufficiently clear and transparent. Integration by agreements can be vacuous if the underlying economic factors are not favorable for integration. Nonetheless, it is important to ask the following questions: Which instrument of integration is more successful and more fundamental in driving trade integration? Is there a logical sequence for policymakers to consider when examining these two channels of integration? In this paper, we will examine these and other questions in detail. Furthermore, given that East Asia and Latin America are two fertile territories in which various forms of PTAs proliferate, we will use the experiences of these two regions extensively as useful illustrations for our work in this paper.

To look ahead, using the experiences of East Asia and Latin America as our guide, our research on the topic of integration of markets vs. integration by agreements suggests *four* conclusions. First, until fairly recently (say the late 1990s), East Asian countries have integrated among themselves primarily via the markets and not by formal, *de jure* trade agreements. In contrast, Latin America has a long history (since the 1960s) of legal trade treaties that attempt to bind themselves together. Second, using various indicators of trade and economic integration, it is clear that East Asian economies are much more integrated among themselves than the economies of Latin America. At least for the important cases of East Asia and Latin America, integration using the marketplace or via *de facto* agreements (together with business-friendly policies by individual countries) leads to more intense integration than *de jure* agreements. Third, from the viewpoint of policymakers who want to strengthen trade relationships regionally, this suggests that the proper *sequencing* of the two forms of integration should first be the freeing of the domestic private sectors which allow them to mature and to use the international markets to integrate, before establishing legal treaties to further deepen the relationships. Lastly, from a political-economic standpoint, it can be seen from the examples in East Asia and Latin America that regional trade agreements often serve several constituents. Trade agreements are both economic agreements as well as foreign policy agreements. Regional trade agreements can also be inward-looking or outward-

oriented. To keep the primary focus on the open-trade and economic objectives, it is thus important to first develop a thick market for exporters and traders, who can pressure the government to pay attention to the signals of the economic forces. We will use a generalized Nash bargaining analysis to illustrate this point. In the next section, we provide a detailed overview of recent development of regional trade agreements in East Asia and in Latin America. In section 3, we provide some information of the extent and characteristics of the trade integration in these two regions. In section 4, we provide a simple analysis of trade policy implementation that illustrates how integration of markets first can lead to more successful trade connections than integration via trade agreements. In section 5, we conclude.

## **2. Regional Trade Agreements in East Asia and Latin America**

In the wake of the progress achieved in Europe and North America, regional cooperation has recently gained momentum all over the world. Regional cooperation is of course not an end in itself but has to be considered as a way of enhancing economic growth and development. Most of the industrial and developing countries have concluded some regional trade and investment agreements.

Compared to other international regions, for instance Latin America, Asia lagged in concluding formal trade agreements as East Asian countries have been more supportive of an open multilateral system. The Asian regional integration can be regarded as a *de facto* regional integration even though recently, by the end of 1990s, most East Asian countries have showed strong interest about *de jure* regionalism. However, the momentum for formal regional integration has been accompanied by the proliferation of bilateral FTAs not only within Asia but also with extra-regional countries, in particular with Latin America.

Latin American countries adopted formal/*de jure* regional integration in the early 1990s, such as NAFTA or MERCOSUR, but in addition to these sub-regional schemes, various bilateral FTAs have emerged both among Latin American countries and with the extra-regional countries by the end of 1990s.

It is noteworthy that, given different choices of regional integration, intra-regional trade in Latin America is much less than that of East Asian countries. We will highlight this

contrast of trade integration in section 3. First let us next discuss the recent history of free trade agreements in East Asia and Latin America.

## **2.1 Trends of Free Trade Areas in East Asia**

It is generally recognized that the FTA of ASEAN (The Association of Southeast Asian Nations) countries signed in 1992 was the starting point of East Asian regionalism. However, in the Asia-Pacific region, regional cooperation took shape as APEC (Asia-Pacific Economic cooperation) at the end of the 1980s. APEC<sup>1</sup> is not a regional trade agreement, but a unique form of economic cooperation for promoting trade and investment liberalization, economic and technical cooperation among Asia-Pacific countries. Although APEC is not an FTA in legal terms, it has a plan to achieve free trade in the region. At the APEC Summit Meeting in Bogor, Indonesia in 1994, the leaders adopted the “Bogor goal”, where they announced their commitment to complete trade and investment liberalization by 2010 in the case of industrial country members and by 2020 in the case of developing country members. At Osaka in November 1995, an agreement was reached on a set of fundamental principles to bring about the liberalization of trade and investment. If the “Bogor goals” are realized and the commitments of the member countries are fully implemented, APEC countries can enjoy a substantial welfare improvement through free trade opportunities in the region, without creating formal trade agreements. APEC adopted an “open regionalism” as the underlying paradigm i.e. with the intention of sharing benefits of free trade with non-members and thus trying to comply with the most favored nation (MFN) principal of the WTO. The work of APEC in trade liberalization did not achieve much success. However, it should not be viewed as a failure of “open regionalism”, but rather the result of the diversification of the APEC agenda, which now includes such topics as anti-terrorism and weapons of mass destruction.

In the late 1990s, Asian economies appeared to seek another path for regional integration, namely Free Trade Areas (FTAs) in the subset of the Asia-Pacific region. ASEAN country members (Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand) have taken action toward trade liberalization. In 1992, the ASEAN Free Trade Area (AFTA) was set up formally to realize a free trade area within 15 years beginning 1 January 1993. In

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<sup>1</sup> The original 12 members that participated in the first APEC meeting in Camberra I 1989 were Japan, Korea, six ASEAN countries, the US, Canada, Australia and New Zealand. Later its membership expanded to 21 economies including China, Russia and Mexico.

September 1994, the time frame was shortened to 10 years with the aim of achieving the AFTA goals by 2003. The membership has been expanded to ten countries to include Vietnam, Myanmar, Laos and Cambodia. ASEAN countries agreed to eliminate tariffs among the original six members by 2010 and for new members by 2015. Moreover, the leaders of ASEAN announced that they aimed to transform AFTA into an ASEAN Economic Community by 2020. Individual countries in ASEAN pursue separate FTAs, which may affect cooperation among the ASEAN countries as a whole. Singapore has signed FTAs with New Zealand, Japan, Australia and the US, and Thailand has concluded an FTA with Australia.

Although the ASEAN economy and trade volume is small compared to major trading blocs, ASEAN became the target of FTAs inside and outside the region. More recently, there have been agreements to study FTAs for broader groups. China has proposed an FTA between China and ASEAN country members. However, the ASEAN countries put forward an ASEAN+3 (including China, Japan and Korea). India also has agreed on a framework of comprehensive economic partnership with ASEAN.

Despite the rise of regionalism in East Asia, regional integration has not long been prevalent in Northeast Asian countries<sup>2</sup>. So far, Northeast Asian countries have not been part of any formal trading areas. There is now some willingness to form FTAs on bilateral sub-regional levels. Korea took the first step in policy shift to free trade agreements. The Korean government decided to pursue FTAs with its trading partners at the Ministerial Committee on International Economic Policy in 1998. Chile was chosen as the first partner for the negotiation of an FTA because of the small size of the bilateral trade and distance between the two countries. Korea's second FTA was with Singapore, also a country with a relatively small bilateral trade volume and less sensitive products. The Korean government is currently undertaken formal negotiation with Japan but the process is not easy. Japan is targeted for a short-term conclusion. The FTA with ASEAN is considered for mid-term, and the US, China and EU for the long run. Currently, Korea is involved with "simultaneous multi-track" negotiations with Japan, ASEAN and Canada. Joint studies for bilateral FTAs are being conducted for India, Mexico, Russia and MERCOSUR.

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<sup>2</sup> There are different geographical definitions of Northeast Asia. The broadest definition would include China, Japan, North and South Korea, Mongolia, Hong Kong, Taiwan and the Russian Far East and Siberia. This paper, concentrates on the three major Northeast Asian economies i.e. China, Japan and South Korea.



Japan has also begun to study the potential of FTAs in the late 1990s. The initial motivation was to defend export market from the regional agreements of other countries. In particular, since the NAFTA greatly affected the Japanese export performance in the region. Japan first thought an FTA with Mexico but negotiations with the Mexican government did not progress smoothly. The first FTA signed by Japan was a “New-age” free-trade agreement<sup>3</sup> with Singapore in October 2002. The agreement included promoting mutual recognition on some licensing procedures and increasing worker mobility between the two countries. In 2004, Japan finally agreed on a FTA with Mexico. Japan also concluded the FTA negotiations with the Philippines in 2004. Currently, Japan is undertaken official negotiations on FTA with Korea and Malaysia. Negotiations for an FTA with Indonesia are also expected to follow and formal negotiation with ASEAN started in April 2005.

China joined the WTO in 2001 and is in the process of meeting its WTO obligations. This is why China’s interest in regional trade agreements is limited. However, China also took initiative in an FTA with ASEAN and has made progress in these negotiations. At a summit meeting held in Phnom Penh in 2002, the leaders of China and ASEAN countries announced the signing of a framework agreement with the objective to establish a FTA within ten years. China, Japan and Korea have also been discussing and investigating the feasibility of a trilateral FTA. Separately, Japan and Korea have announced that they will conclude a bilateral FTA by the end 2005. A China and Korea bilateral FTA may be the next one. China is hesitant to form a FTA with Japan and competes with Japan in the race for FTAs with ASEAN. It seems that China is ahead in a FTA with ASEAN as a group, but with regard to FTAs with individual ASEAN countries, Japan is further along. China is also seeking FTAs with Chile, New Zealand. Table 1 gives an overview of the intra-regional and extra-regional arrangements in East Asia.

These are manifestations of a real willingness in East Asia toward closer regional cooperation. While ASEAN is often presumed to be the most important economic cooperation in the region, its impact on promoting intra-regional trade and investment has been limited. The initiation of FTAs was soon followed by the 1997 financial crisis affecting the region. Since then, paradoxically, the regional financial proposals are moving faster than any serious

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<sup>3</sup> The « New Age » Partnership goes beyond a traditional free trade agreement. It focuses on new issues such as: “rules governing foreign investment, e-commerce regulations, trade in services, harmonization of technical standards, sanitary and phyto-sanitary regulations, and the streamlining of customs procedures” Hertel, Walsley and Itakura (2001).

intention of regional economic cooperation<sup>4</sup>. Traditionally, trade arrangements are most prominent regional groupings and, precede any financial integration. The European Monetary Union started with a customs union, and developed into a single currency full-fledged economic area. In comparison, the relationship between the economic and financial components of the East Asian regional process is ill defined. There now appears to be little or no coordination between economic and financial initiatives.

In any case (economic or financial cooperation), Northeast Asian economies are expected to play a key role in regional integration. Further, a change in the attitudes of Japan and China is emerging. Both countries seem to be more resolute about a regional grouping than before. A shift of the center of gravity of political initiatives toward closer economic and financial cooperation has been perceivable. Given the slow progress within AFTA and the importance of the Northeast Asian countries in terms of size and weight in the Asian economy, a free trade arrangement between China, Japan and Korea could be achieved prior to wider agreements in the style of ASEAN+3. Furthermore, since it is difficult to expect an East Asia FTA in which at least one of the three major Northeast Asian countries does not participate, a *de facto* Northeast Asia cooperation is a necessary condition for an East Asian integration. Thus, a China-Japan-Korea cooperation is crucially important for the formal economic integration of both Northeast and East Asia.

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<sup>4</sup> The new international environment and the Asian currency crisis have created a strong impetus for regional financial cooperation and have provided Asian countries with a common interest, which has led to the Chiang Mai Initiative (CMI) agreement (May 2000) on bilateral swaps and discussions of the possibility of creating a monetary union among the ASEAN+3 as a long-run objective. More recently, at the informal ASEAN+3 Finance and Central Bank Deputies' Meeting held in Tokyo on 13 November 2002, Korea made a proposal to discuss regional bond market development under the ASEAN+3. In furtherance of this proposal, Japan presented a comprehensive approach to foster bond markets in Asia, the "Asian Bond Markets Initiative" at an ASEAN+3 informal session held in Chiang Mai on December 2002.

**Table 1: Economic Cooperation Agreements in East Asia**

Intra-Regional	Year of in force	Type of agreement	Status
<b>Multi-Countries Agreements</b>			
Asia-Pacific Trade Agreement (APTA)	1976	Partial Scope	Implemented
ASEAN Free Trade Area (AFTA)	1992	Free Trade Agreement	Implemented
East Asia Free Trade Area (EAFTA)	2000	Free Trade Agreement	Proposed
China-Japan-Korea Free Trade Area	2000	Free Trade Agreement	Proposed
APTA-Accession of China	2002	Partial Scope Accession	Implemented
Japan-ASEAN Closer Economic Partnership	2002	Partial Scope	Signed and realization by 10 yrs
Singapore-EFTA (Iceland, Norway, Switzerland)	2003	Free Trade Agreement	Implemented
ASEAN-China Free Trade Area (ACFTA)	2003	Partial Scope	Signed and realization by 2010
ASEAN-India Regional Trade Agreement	2003	Econ Integration Agreement	Signed
ASEAN-Korea Free Trade Area	2004	Partial Scope	On-going negotiations
Trans-Pacific Strategic Economic Partnership	2006	Free Trade Agreement	Signed
Korea-EFTA (Iceland, Norway, Switzerland)	2006	Free Trade Agreement	Signed
<b>Bilateral Agreements</b>			
Laos-Thailand	1991	Partial Scope	Implemented
Singapore-New Zealand	2001	Econ Integration Agreement	Implemented
Singapore-Japan	2002	Free Trade Agreement	Signed
Singapore-Australia	2003	Free Trade Agreement	Implemented
Japan-Korea	2003	Free Trade Agreement	On-going negotiations
Thailand-India	2003	Econ Integration Agreement	Implemented
China-Hong Kong (CEPA)	2004	Econ Integration Agreement	Signed
China-Macao	2004	Econ Integration Agreement	Signed
Korea-Chile	2004	Econ Integration Agreement	Signed
Singapore-United States	2004	Econ Integration Agreement	Signed
Hong Kong-New Zealand	2005	Econ Integration Agreement	On-going negotiations
Japan-Mexico	2005	Econ Integration Agreement	On-going negotiations
Thailand-Australia	2005	Econ Integration Agreement	Implemented
Thailand-New Zealand	2005	Free Trade Agreement	Signed
Singapore-Canada	2006	Free Trade Agreement	On-going negotiations
Singapore-Chile	2006	Free Trade Agreement	On-going negotiations
Singapore-India	2005	Free Trade Agreement	On-going negotiations
Singapore-Jordan	2005	Free Trade Agreement	On-going negotiations
Singapore-Korea	2006	Free Trade Agreement	On-going negotiations
Singapore-Mexico	2006	Free Trade Agreement	On-going negotiations
Singapore-Panama	2006	Free Trade Agreement	On-going negotiations
China-Chile	2006	Free Trade Agreement	On-going negotiations
Japan--Canada	2006	Econ Integration Agreement	On-going negotiations
Japan-Malaysia	2006	Free Trade Agreement	On-going negotiations
Korea-Australia	2006	Econ Integration Agreement	On-going negotiations
Korea-New Zealand	2006	Econ Integration Agreement	On-going negotiations
Korea-United States	2007	Econ Integration Agreement	On-going negotiations
Korea-Mexico	2007	Econ Integration Agreement	On-going negotiations
Japan-Chile	2007	Econ Integration Agreement	On-going negotiations
Malaysia-United States	2007	Econ Integration Agreement	On-going negotiations
Philippines-United States	2007	Econ Integration Agreement	On-going negotiations

Sources: WTO web data and various info from the web.

## 2.2 Origins of the New Asian Regionalism

Before 1997, most Asian economists considered East Asian economic cooperation (through trade and investment) as an example of a successful *de facto* regionalism i.e. explained by the play of pure economic forces. However, the financial crisis of 1997-98 demonstrated the weaknesses of informal regional cooperation and gave East Asians a strong impetus to search for a regional mechanism that could forestall future crisis. This search is now gathering momentum and opening the door to possibly significant *de jure* integration in East Asia.

The Asian financial crisis is often regarded as the outbreak for the rise in regionalism in East Asia. The crisis and its subsequent contagion to a number of economies in Northeast and Southeast Asia painfully demonstrated that the East Asian economies were closely related and a resolution to the crisis could require a regional cooperation. A rising sense of East Asian identity has emerged since the crisis. After the proposal to create an Asian Monetary Fund (AMF) failed to lead to progress, the leaders of ASEAN responded by inviting China, Korea and Japan to join in an effort to seek economic cooperation in the region. The ASEAN+3 Summit in November 1999 released a “Joint Statement on East Asian Cooperation” that covers a wide range of possible areas for regional cooperation. In the early 2000s, other new economic situations - such as the quick recovery and recurring growth in Korea, the emergence of China as a fast post-crisis growing economy and the continuing stagnant state of Japan - gave rise to a new Asian economic regionalism and FTAs. It is noteworthy that FTAs projects are numerous and proliferating at startling speed. These include regional agreements as well as bilateral treaties<sup>5</sup>.

Although the financial crisis might have been the direct cause, a number of additional factors contributed to the breakthrough and proliferation of the policy-led regionalism in East Asia. First, regionalism was the natural result of decades of fast growth and a number of economic restructuring and industrial transformations in East Asia, particularly in Northeast Asia (with the emergence of Japan as a major industrial power in the 1960s, and rapid growth of the newly industrializing economies of Northeast and Southeast Asia in the late 1970s and 1980s). These economic developments have created a new center of East Asia economic

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<sup>5</sup> Most intra-regional trade agreements of Asian countries are FTAs, the effect of which is to eliminate trade barriers between members. Following the Japanese, the term “Economic Partnership Agreement” (EPA) is also used, which intends to imply that the scope of the agreement is broader than the elimination of barriers of trade in goods.

power that has begun to compete with North America and Europe in terms of its contribution to world output and world trade. Second, it was the result of a “benign neglect” from international organizations such as the IMF in the aftermath of the Asian crisis (Tran Van Hoa, 2002). East Asian economic policy makers perceived international institutions and the main global trading powers (especially, the US) fell short in their support for the region. That is why to escape this crisis, countries initially attempted some kind of “go-it-alone” strategy (for example, uncontrolled devaluations, interruption of payments...). These countries were rapidly called to order by the IMF in the name of global world interest. The IMF’s reaction illustrated for regional policy makers not only the inefficiency of a “go it alone” strategy but also the lack of institutional regional coordination in Asia. Finally, the successful integration initiatives in other parts of the world, such as the EU and NAFTA, illustrated for academics and politicians the possibilities that deepening and widening economic cooperation could bring in East Asia. For a long time most East Asian countries, and in particular Japan, considered multilateral agreements (in the sense of WTO) alone sufficient to establish fair economic relationships. They were strongly encouraged by the USA in that way of thinking. However, when the USA itself decided to engage in regional agreements with first Canada and then Mexico in 1992, the Asian countries started to dread being left isolated between what seemed to be possible future trade blocs. Understanding the logic of NAFTA and EU was a lesson to Asian countries: regional agreements are a mix of political and economic objectives. Once traditional barriers to trade and investment are eliminated, there are still many other impediments to abolish. The regional integration is in fact a result of economic forces and political willingness. In the case of East Asia, political issues have long been major obstacles to regional economic cooperation. Nonetheless, prospect for *de jure* regionalism in East Asia is not totally disappeared as new approaches and initiatives are in recent times put forward by the regional states. East Asian regionalism is undergoing a phase of new interpretation. It is no longer limited in an economic sense. Growing interdependence and tightening financial links are not sufficient to make this regionalization more consistent: strategic thinking is being inserted as the concept of regionalism begins to expand in terms of both geography and agenda<sup>6</sup>.

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<sup>6</sup> This has been done at the Chinese initiative, with Japan trying to follow. Beijing is increasingly driving East Asia’s agenda. China’s suggestion to extend invitation to India, New Zealand, and Australia, but not to the USA for the East Asian Summit meeting in November 2005 in Malaysia was accepted by the members of ASEAN+3, and it reflects China’s growing influence over East Asia’s emerging regional architecture.

### **2.3 Trends of Free Trade Areas in Latin America**

Free trade is not a new concept in Latin America. Globally, we can consider three phases of FTA process in Latin America.

#### **First stage (1960s): FTAs created in the context of import substitution industrialization**

Since the 1940s regional economic integration in Latin America was considered as an instrument of promoting economic growth and industrialization. In the 1960s, there were a number of arrangements in order to promote regional economic integration, most of which met with limited success. The Latin American Free Trade Association (LAFTA) created in 1960 incorporated the inward-looking import substitution orientation for Latin American industrialization policies. In order to deepen the import substituting industrialization process, those countries which had small markets tried to reach economies of scale through the preferential opening of their markets. In 1969, The Andean Pact was conducted as a sub-regional agreement within LAFTA. LAFTA and the Andean Pact were not capable of increasing trade in the region. These agreements were negotiated on a product-by-product approach instead of covering all sectors of the economy. The Central American Common Market (CACM) formed by Costa Rica, El Salvador, Guatemala, and Honduras followed an inward-oriented trade strategy but was more successful in promoting intra-regional trade. The objective was to reach a common market which would provide a preferential market for import substituting industries. During the 1970s, the CACM suffered a crisis and in 1986, the collapse of the Central American clearing mechanism marked the disintegration of the CACM.

The 1980s were a decade of major economic transformation for the Latin American economies: Latin American countries started drastic policy reforms based on “neoliberalism”, abandoning interventionist strategy that had brought the region’s financial and economic crisis. This context led to the liberalization of most Latin American trade policies and to the adoption of outward-oriented trade policies coupled with economic stabilization and the privatization of public firms. The Latin American countries made revisions to the trade agreements of the previous period with the idea of renewing the process of regional integration in the sense of taking into account the need of Latin American economies to compete in the international market and to improve market access for their exports. Bhagwati

(1992) considered that as a “second regionalization based on open trade compared to the first regionalization based on protection”.

### **Second stage (1990s): Intra-regional FTAs to complement and support the economic liberalization process**

The Andean Pact was reviewed in order to take into account not only trade in goods but also liberalization in other areas. In spite of this integration effort, the level of intra-regional trade remained quite low.

In March 1991, Argentina, Brazil, Paraguay and Uruguay signed the Asuncion Treaty which established MERCOSUR. Later, Chile and Bolivia have joined MERCOSUR as associate members in the framework of an ECA.

At the same time, there has also been a proliferation of bilateral or trilateral regional initiatives. The pioneering bilateral trade agreement between Chile and Mexico went into force in January 1992. The agreement was officially called ECA<sup>7</sup> 17 of ALADI (Latin American Integration Association). One year before the Mexico-Chile ECA was ratified, the Argentina-Chile ECA went into force, which was called ECA 16 of ALADI. These two ECAs as well as many other trade agreements among Latin American countries were negotiated in the framework of ALADI. This is why the ALADI can be regarded as a kind of “umbrella” agreement facilitating the negotiation and realization of regional trade arrangements.

In 1994, the bilateral trade agreement between Canada and the US was extended to Mexico in order to form the North American Free Trade Agreement (NAFTA). Besides multi-country economic integrations such as NAFTA and MERCOSUR, many bilateral agreements have emerged in Latin America since the early 1990s. Particularly two Latin American countries, Chile and Mexico, have independently pursued bilateral FTAs with other countries in Latin America. After the NAFTA was established, Mexico extended FTAs to several countries of Latin America. In 1995, the trilateral FTA with Colombia and Venezuela was negotiated to form the G3 Agreement (El Grupo de los Tres). FTAs with Costa Rica and Bolivia went into force in 1995 and FTA with Nicaragua in 1998. Later, Mexico started the

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<sup>7</sup> Economic Complementation Agreements (ECAs) basically cover trade of goods although they give the possibilities of future negotiation of other areas.

negotiation with three other countries of Central America together (El Salvador, Guatemala and Honduras) and, individually with Panama, Ecuador, Peru, Belize, Trinidad and Tobago, and Dominican Republic.

As for Chile, liberalization through bilateral FTAs was assumed to be one of the most effective instruments of trade policy for a small country such as Chile. Chile established bilateral ECAs with Argentina and Mexico and started FTAs in the ALADI framework with Venezuela and Bolivia in 1993, Colombia in 1994, Ecuador in 1995, MERCOSUR in 1996, and Peru in 1998. Chile also initiated bilateral negotiation with Canada which went into force in 1997, and with the Central American Common Market in 1999.

In this way, Mexico and Chile have been converting into “hubs” of FTAs in Latin America from the mid 1990s.

### **Third stage (end of 1990s-2000s): Inter-regional FTAs**

By the end of 1990s, both Mexico and Chile started to look for establishing FTAs with extra-regional countries. This trend can be considered as the new trade policy of these countries in order to diversify economic links with major extra-regional countries like European or Asian economies. This is why Mexico and Chile are assumed to be “hubs” that involves not only in Latin America, but also inter-regional FTAs connecting existing or newly establishing integration schemes in other regions. For instance, Chile formed FTAs with Canada, the US and Korea. It signed the Association Agreement with the EU in 2002. Mexico formed an FTA with the EU and Israel by the end of 2000. The two countries showed also strong interests in forming bilateral framework with Asian countries in particular. For instance, Chile signed FTA with Korea in 2002 and this is the first FTA between Asia and Latin America. Japanese government has already started negotiation with Mexican government about future economic cooperation that covers FTA between the two countries.

Other negotiations are ongoing, focusing on trade relationship with the United States. Recently, some of the region’s countries such as Colombia, Costa Rica, Panama and Peru, centred on trade links with the United States, showing that the integration process is in a change in Latin America. The Dominican Republic-Central America-USA FTA has come into effect in all member countries, except in Costa Rica, where it is in the process of being



ratified. The Bolivarian Republic of Venezuela withdrew from the Andean Community concluded negotiations for a FTA with the United States. Table 2 illustrates effective regional arrangements in Latin America.

It is noteworthy that these movements in Latin America towards bilateral FTAs could have significant influences on the recent movement in Asia for establishing bilateral FTA, thus accelerating initiatives for bilateral FTA in Asia-Pacific.

**Table 2: Economic Cooperation Agreements in Latin America**

Intra-Regional	Year of in force	Type of agreement	Status
<b>Multi-Countries Agreements</b>			
CACM (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua)	1961	Customs Union	Implemented
CARICOM (incl. 15 Caribbean countries)	1973/97	Customs Union and EIA	Implemented
LAIA (Argentina, Bolivia, Brazil, Chile, Colombia, Cuba, Ecuador, Mexico, Paraguay, Peru, Uruguay, Venezuela)	1981	Partial Scope	Implemented
Andean (Bolivia, Colombia, Ecuador, Peru, Venezuela)	1988	Customs Union	Implemented
MERCOSUR (Argentina, Brazil, Paraguay, Uruguay; Venezuela joined 2006)	1991/05	Customs Union and EIA	Implemented
NAFTA (Canada, Mexico, United States)	1994	Econ Integration Agreement	Implemented
G3 (Colombia, Mexico, Venezuela)	1995	Free Trade Agreement	Implemented
Chile-MERCOSUR	1996	Econ Integration Agreement	Implemented
Bolivia-MERCOSUR	1997	Econ Integration Agreement	Implemented
MERCOSUR-European Communities	1999	Cooperative Agreement	Implemented
Mexico-European Communities	2000	Econ Integration Agreement	Implemented
Mexico-EFTA	2001	Econ Integration Agreement	Implemented
Mexico-Central America	2001	Free Trade Agreement	Implemented
Mexico-MERCOSUR	2002	Econ Integration Agreement	Signed
Chile-European Communities	2003	Free Trade Agreement	Signed
Peru-MERCOSUR	2003	Econ Integration Agreement	Signed
MERCOSUR-India	2003	Econ Integration Agreement	Signed
Chile-EFTA	2004	Econ Integration Agreement	Signed
Dominican Rep.-Central America-United States	2006	Free Trade Agreement	Signed
<b>Bilateral Agreements</b>			
Chile-Argentina	1991	Econ Integration Agreement	Implemented
Mexico-Argentina	1991	Econ Integration Agreement	Implemented
Chile-Mexico	1992/98	EIA and Free Trade Agreement	Implemented
Chile-Bolivia	1993	Econ Integration Agreement	Implemented
Chile-Venezuela	1993	Econ Integration Agreement	Implemented
Chile-Colombia	1994	Econ Integration Agreement	Implemented
Mexico-Bolivia	1994/95	EIA and Free Trade Agreement	Implemented
Chile-Ecuador	1995	Econ Integration Agreement	Implemented

Mexico-Costa Rica	1995	Free Trade Agreement	Implemented
Mexico-Peru	1996	Econ Integration Agreement	Implemented
Chile-Canada	1997	Free Trade Agreement	Implemented
Mexico-Nicaragua	1998	Free Trade Agreement	Implemented
Chile-Peru	1998	Econ Integration Agreement	Implemented
Mexico-Israel	2000	Free Trade Agreement	Implemented
Mexico-Cuba	2001	Econ Integration Agreement	Implemented
Mexico-El Salvador	2001	Free Trade Agreement	Implemented
Mexico-Guatemala	2001	Free Trade Agreement	Implemented
Mexico-Honduras	2001	Free Trade Agreement	Implemented
Mexico-Brazil	2002	Econ Integration Agreement	Signed
Chile-Costa Rica	2002	Free Trade Agreement	Implemented
Chile-El Salvador	2002	Econ Integration Agreement	Implemented
Costa Rica-Canada	2002	Free Trade Agreement	Signed
Chile-Korea	2003	Econ Integration Agreement	Signed
Mexico-Uruguay	2003	Free Trade Agreement	Signed
El Salvador-Panama	2003	Free Trade Agreement	Signed
Chile-United States	2004	Econ Integration Agreement	Signed

Sources: WTO web data and various info from the web.

## **2.4 Driving forces of the recent development of regionalism in Latin America**

The development of regionalism in Latin America in the 1990s can be explained by several factors (Hosono, A., Nishijima S., 2003). The most significant ones are the following:

- Economic liberalization of the 1980s: Latin American countries started radical policy reforms in the middle of the 1980s, leaving behind interventionist policies responsible for economic crises in the 1980s. Upshots of these policy reforms were seen mostly in the trade and capital liberalization.
- Increasing regionalism of the US: The US foreign trade policy had been based on a mix of multilateralism and bilateralism until the end of the 1980s. From then on, the US showed an inclination towards regionalism with the formation of NAFTA and APEC. In response to these changes in the US attitude towards regionalism, Latin American countries adopted different behaviors:
  - Some countries expressed strong impetus about joining FTA of Americas, on the US initiative and leadership;

- Other countries, such as Chile, started a negotiation to join NAFTA;
- Southern Cone countries, such as Brazil and Argentina, formed a sub-regional integration i.e. MERCOSUR, to counterbalance against the regionalism of the US;
- Mexico and Chile enhanced bilateral intra and extra-regional FTAs;
- The Andean Community is recently going through a period of adjustment and redefinition following the withdrawal of Venezuela, the extend-membership to Chile and the signature by Colombia and Peru of bilateral trade agreements with the United States.

The new trend of extra-regional integration in the 2000s, in particular the proliferation de bilateral FTAs, conducted by Mexico and Chile, could be explained as the natural result of the deepening and widening process of FTA. However, these two countries have different reasons for promoting their FTAs with extra-regional countries. Taking into account the dependency of Mexico on the US market after its participation to the NAFTA, Mexico showed an inclination to diversify and strengthen economic relationship with extra-regions through expanding bilateral FTAs. As for Chile, it is one of the most liberalized countries in the world, opting for unilateral trade liberalization. It is then very important for Chile to induce trade liberalization of partner countries within Latin America or outside the region.

By examining the brief history of trade agreements in both East Asia and Latin America above, we can see the following:

*East Asia first integrated via the markets and then in the 1990s started integrating via agreements. Latin America since the 1960s has mainly used trade agreements as the primary channel for integration.*

*It is then interesting to evaluate the depth of the trade integration for these two regions which have chosen two different ways of integration.*

### **3. Characteristics and Intensity of Trade Integration in East Asia and Latin America**

In this section we will examine the characteristics and intensity of regional trade integration in both East Asia and Latin America. Table 3 compares the degrees of intra-regional trade for all goods in East Asia and Latin America over time. The East Asian economies considered include ASEAN countries (Cambodia, Indonesia, Malaysia, Philippines, Singapore, Thailand and Vietnam) and North East Asian countries (China, Hong Kong, Japan, Macao, republic of Korea and Taiwan) while the Latin American economies include ANDEAN countries (Bolivia, Colombia, Ecuador, Peru and Venezuela), MERCOSUR (Argentina, Brazil, Paraguay and Uruguay, Venezuela is excluded due to new membership in 2006) and NAFTA countries (Canada, Mexico and United States).

It can easily be seen that the East Asian economies are much more integrated among themselves than the Latin American economies, excluding Canada and the United States. In 2005, 50.5% of East Asian exports went to other East Asian economies. The comparable figure for Latin America (LAIA including those countries in ANDEAN Community and MERCOSUR plus Chile and Mexico) was only 13.2%. Trade integration in East Asia was already high before the 1997-98 Asian financial crises. In 1995, 48.7% of East Asian exports were intra-regional, as compared with 17.2% in Latin America. One could assume that taking into account Northeast Asian countries, specially, China, Japan and Korea, could change results and produce very high level of integration comparing to Latin American countries. This is why it is interesting to compare ASEAN to Latin American countries with an additional distinction between Central and South America. Table 3 shows that, during the whole period under study, trade integration among ASEAN countries (25.2% in 2005) is higher than the trade integration among ANDEAN community (8.2% in 2005) or MERCOSUR countries (12.9% in 2005).

Thus one can surmise that *de facto* trade agreements or integration via the markets were effective in helping East Asia integrate, while *de jure* trade agreements do not seem to lead to more intra-regional trade integration in Latin America.

Generally one may surmise that trade integration may tend to occur to a greater extent for manufactured goods. Furthermore, given the rising importance of trade in components and

parts, it is expected that integration via trade in components and parts should be even more intense (Yi, 2003; Ng and Yeats, 2003). Global and regional production sharing and vertical specialization have become increasingly important. In the next Table we wish to highlight intra-regional trade of manufactured goods and components and parts within these two regions for various years. Table 4 shows clearly that for both manufactured goods and components and parts, intra-regional trade is relatively more pronounced in East Asia than in Latin America. 48.5% of East Asian exports of manufactured goods were shipped to other East Asian economies in 2005. The corresponding share for Latin America (LAIA) was only 17.1%. However, if we compare ASEAN to ANDEAN and MERCOSUR countries, results are different: 25.1% of ASEAN exports of manufactured goods were shipped to other East Asian economies in 2005; the corresponding share for ANDEAN countries was 34.3% and 20.2% for MERCOSUR. As for parts and components, the share of East Asian intra-regional exports of components and parts amounted to 59.3% in 2005, as compared to 14.00% in Latin America (LAIA). But if we compare ASEAN to ANDEAN and MARCOSUR countries, results are different: 29.6% of ASEAN exports of parts and components were shipped to other East Asian economies in 2005, while the corresponding share for ANDEAN countries was 39.5% and 22.6% for MERCOSUR.

**Table 3: East Asia and Latin America Intra-Regional Trade in Various Years**

Year	Share of Intra-Regional Exports in East Asia to the World (%)			Share of Intra-Regional Exports in Latin America to the World (%)				
	ASEAN	NE Asia	East Asia	ANDEAN	MERCOSUR	LAIA	NAFTA	LAC
1985	18.7	23.3	34.2	2.6	5.5	10.0	42.9	46.1
1990	19.0	27.8	39.8	4.2	8.9	10.9	41.3	44.5
1995	24.9	34.5	48.7	12.1	20.5	17.2	46.0	50.5
2000	23.0	34.5	47.3	9.1	20.9	13.1	55.7	58.8
2005	25.2	39.2	50.5	8.2	12.9	13.2	55.8	57.2

Notes: ASEAN includes Cambodia, Indonesia, Malaysia, Philippines, Singapore, Thailand and Vietnam due to missing data for Brunie, Laos and Myanmar. Cambodia and Vietnam are missing data in 1985-1995.

NE Asia includes China, Hong Kong, Japan, Macao, Korea Rep., and Taiwan.

East Asia includes those countries in ASEAN and NE Asia.

ANDEAN includes Bolivia, Colombia, Ecuador, Peru and Venezuela.

MERCOSUR includes Argentina, Brazil, Paraguay and Uruguay (Venezuela is excluded due to new member in 2006).

LAIA includes those countries in ANDEAN and MERCOSUR plus Chile and Mexico.

NAFTA includes Canada, Mexico and United States.

LAC includes all countries in LAIA and NAFTA.

Source: Computations by authors based on UN COMTRADE Statistics.

**Table 4: East Asia and Latin America Intra-Regional Trade of Manufactured Goods and Parts & Components in Various Years**

Year	Share of Intra-Regional Exports in East Asia to the World (%)			Share of Intra-Regional Exports in Latin America to the World (%)				
	ASEAN	NE Asia	East Asia	ANDEAN	MERCOSUR	LAIA	NAFTA	LAC
<b>Manufactured Goods</b>								
1985	22.1	19.0	25.7	13.5	7.8	18.4	46.7	50.9
1990	19.9	25.5	35.4	14.6	10.5	17.0	43.1	47.0
1995	26.3	32.3	46.0	39.3	26.5	19.6	47.8	53.7
2000	23.3	33.0	44.9	33.2	27.0	13.0	55.5	59.8
2005	25.1	38.3	48.5	34.3	20.2	17.1	54.3	58.9
<b>Parts &amp; Components</b>								
1985	22.8	23.2	31.2	9.5	8.0	17.3	41.3	46.1
1990	27.0	32.1	44.4	12.8	12.4	16.8	45.3	49.3
1995	32.1	34.3	51.9	40.1	34.2	17.5	45.9	51.3
2000	29.0	38.0	54.3	39.4	30.2	10.0	53.0	57.5
2005	29.6	45.8	59.3	39.5	22.6	14.0	53.0	58.0

Notes: Manufactured goods is defined as SITC 5+6+7+8-68 in Revision 2.

Parts & components include 75 items of parts in machinery, transport equipment and textiles & clothing.

Cambodia and Vietnam are missing data in 1985 to 1995 in East Asia.

Source: Computations by authors based on UN COMTRADE Statistics.

Table 4 also shows that the intensification of intra-regional trade in Latin America started in the 1990s, while the pace of trade integration started prior to the proliferation of formal regional trade agreements in East Asia. In 1990, the shares of ASEAN intra-regional exports of manufactured goods and components and parts were 19.9% and 27.00%, respectively. The corresponding shares in Latin America were 14.6% and 12.8% for ANDEAN community and 10.5% and 12.4% for MERCOSUR countries.

Essentially East Asian integration was driven by market conditions. Integration via markets occurs before attempts to establish more formal regional trade agreements. For Latin America, *de jure* trade agreements seem to have led to a slight acceleration of the pace of intra-regional trade.

Another way we can analyze the intensity of regional trade integration is through the use of the trade intensity index. The trade intensity index is defined as:

$$\frac{X_{ij}}{X_i} \bigg/ \frac{X_{wj}}{X_w}$$

where  $X_{ij}$  and  $X_{wj}$  are country  $i$  and world exports to country  $j$ ;  $X_i$  and  $X_w$  are country  $i$  and world total exports. The numerator indicates the share of country  $i$ 's export to country  $j$  in total export of the country  $i$ , and the denominator indicates the share of world's export to country  $j$  in its total export. If the bilateral trade intensity index has a value greater than one, the export of country  $i$  outperforms in country  $j$ . It implies that country  $j$  is relatively important to country  $i$ 's exports.

In Table 5, we present calculations of the trade intensity indices for East Asian countries as well as some of their major trading partners for 2005. To further highlight their trade relationship, we also provide the overall trade matrix for the region. The overall East Asia-East Asia trade index is 5.9, as compared to the Latin American (LAIA) trade index of 3.6 (Table 6). For an in-depth analysis, we compare ASEAN index to ANDEAN and MERCOSUR countries. The ASEAN index is 7.2 while the indices for ANDEAN and MECOSUR are respectively 13.5 and 12.6. These results show highlight that trade integration is higher among Latin American countries participating to regional agreements. However, the regional point of view highlights a more pronounced integration in East Asia (5.9), with more recent and less regional trade agreements, compared to Latin America, including the United States and Canada (5.0).

Table 5: Matrix of East Asian Trade in All Goods, 2005

Partner (Importer)	Exporting Country												ASEAN	NE Asia	E Asia-12
	Cambodia	China	Hong Kong	Indonesia	Japan	Korea	Malaysia	Philippines	Singapore	Taiwan	Thailand	Vietnam			
	<b>Export Value in All Goods (\$ million)</b>														
Cambodia	0	536	497	94	78	144	109	8	303	331	915	556	1,985	1,586	3,571
China	13	0	130,426	6,662	80,074	61,915	9,302	4,077	19,757	40,879	9,134	3,246	52,192	313,294	365,486
Hong Kong, China	616	124,473	0	1,492	35,960	15,531	8,242	3,341	21,522	30,721	6,128	353	41,694	206,685	248,379
Indonesia	2	8,350	1,265	0	9,214	5,046	3,322	476	22,103	2,336	3,960	469	30,332	26,211	56,543
Japan	25	83,986	15,304	18,049	0	24,027	13,184	7,206	12,532	14,481	15,029	4,340	70,366	137,798	208,164
Korea, Rep.	25	35,108	6,540	7,086	46,630	0	4,739	1,391	8,052	5,575	2,250	664	24,207	93,852	118,060
Malaysia	9	10,606	2,419	3,431	12,531	4,608	0	2,459	30,385	4,154	5,685	1,028	42,998	34,319	77,316
Philippines	2	4,688	2,635	1,419	9,057	3,220	1,974	0	4,184	4,220	2,050	829	10,459	23,820	34,279
Singapore	10	16,632	6,046	7,837	18,436	7,407	22,009	2,707	0	7,656	7,459	1,917	41,939	56,177	98,116
Taiwan, China	4	16,550	6,769	2,475	43,578	10,863	3,912	1,888	8,976	0	2,694	935	20,884	77,760	98,644
Thailand	17	7,819	3,001	2,246	22,451	3,381	7,586	1,169	9,402	3,718	0	863	21,284	40,370	61,654
Vietnam	42	5,644	1,308	678	3,592	3,432	1,160	312	4,421	4,057	2,357	0	8,971	18,032	27,003
ASEAN	83	54,276	17,170	15,706	75,359	27,237	36,162	7,131	70,798	26,472	22,426	5,662	157,968	200,514	358,482
NE Asia	682	260,117	159,039	35,764	206,243	112,336	39,380	17,903	70,839	91,655	35,235	9,538	209,343	829,390	1,038,733
East Asia (12)	765	314,393	176,209	51,470	281,602	139,573	75,542	25,034	141,637	118,127	57,662	15,200	367,310	1,029,904	1,397,214
EU (27)	593	145,613	42,942	10,347	87,819	44,354	16,614	7,014	27,907	22,124	15,019	5,547	83,041	342,851	425,892
LAC (13)	1,410	192,173	53,088	11,478	158,201	54,543	29,879	7,961	26,411	33,272	19,702	6,601	103,442	491,277	594,719
World	2,798	761,953	292,119	85,660	594,941	284,418	140,963	41,255	229,652	189,393	110,110	32,447	642,885	2,122,824	2,765,709
	<b>Share of Intra-Regional Trade in All Goods from Importer (%)</b>														
Cambodia	0	15.0	13.9	2.6	2.2	4.0	3.1	0.2	8.5	9.3	25.6	15.6	55.6	44.4	100.0
China	0.0	0	35.7	1.8	21.9	16.9	2.5	1.1	5.4	11.2	2.5	0.9	14.3	85.7	100.0
Hong Kong, China	0.2	50.1	0	0.6	14.5	6.3	3.3	1.3	8.7	12.4	2.5	0.1	16.8	83.2	100.0
Indonesia	0.0	14.8	2.2	0	16.3	8.9	5.9	0.8	39.1	4.1	7.0	0.8	53.6	46.4	100.0
Japan	0.0	40.3	7.4	8.7	0	11.5	6.3	3.5	6.0	7.0	7.2	2.1	33.8	66.2	100.0
Korea, Rep.	0.0	29.7	5.5	6.0	39.5	0	4.0	1.2	6.8	4.7	1.9	0.6	20.5	79.5	100.0
Malaysia	0.0	13.7	3.1	4.4	16.2	6.0	0	3.2	39.3	5.4	7.4	1.3	55.6	44.4	100.0
Philippines	0.0	13.7	7.7	4.1	26.4	9.4	5.8	0	12.2	12.3	6.0	2.4	30.5	69.5	100.0
Singapore	0.0	17.0	6.2	8.0	18.8	7.5	22.4	2.8	0	7.8	7.6	2.0	42.7	57.3	100.0
Taiwan, China	0.0	16.8	6.9	2.5	44.2	11.0	4.0	1.9	9.1	0	2.7	0.9	21.2	78.8	100.0
Thailand	0.0	12.7	4.9	3.6	36.4	5.5	12.3	1.9	15.3	6.0	0	1.4	34.5	65.5	100.0
Vietnam	0.2	20.9	4.8	2.5	13.3	12.7	4.3	1.2	16.4	15.0	8.7	0	33.2	66.8	100.0
ASEAN	0.0	15.1	4.8	4.4	21.0	7.6	10.1	2.0	19.7	7.4	6.3	1.6	44.1	55.9	100.0
NE Asia	0.1	25.0	15.3	3.4	19.9	10.8	3.8	1.7	6.8	8.8	3.4	0.9	20.2	79.8	100.0
East Asia (12)	0.1	22.5	12.6	3.7	20.2	10.0	5.4	1.8	10.1	8.5	4.1	1.1	26.3	73.7	100.0
EU (27)	0.1	34.2	10.1	2.4	20.6	10.4	3.9	1.6	6.6	5.2	3.5	1.3	19.5	80.5	100.0
LAC (13)	0.2	32.3	8.9	1.9	26.6	9.2	5.0	1.3	4.4	5.6	3.3	1.1	17.4	82.6	100.0
World	0.1	27.6	10.6	3.1	21.5	10.3	5.1	1.5	8.3	6.8	4.0	1.2	23.2	76.8	100.0



<b>Cont. Table 5</b>																
Partner (Importer)	Cambodia	China	Hong Kong	Indonesia	Japan	Korea	Malaysia	Philippines	Singapore	Taiwan	Thailand	Vietnam	ASEAN	NE Asia	E Asia-12	
<b>Trade Balance in All Goods (\$ million)</b>																
Cambodia	0	509	488	93	-27	138	101	6	203	326	883	395	1,682	1,434	3,115	
China	-328	0	-4,540	819	-28,403	23,267	-3,871	943	-759	20,951	-2,024	-2,653	-7,873	11,275	3,402	
Hong Kong, China	206	112,248	0	1,201	34,389	13,488	5,390	1,319	17,314	28,834	4,626	-882	29,175	188,960	218,134	
Indonesia	-77	-87	-659	0	-11,603	-3,139	-1,052	-616	11,656	-2,202	832	-231	10,510	-17,689	-7,179	
Japan	-59	-16,421	-17,732	11,143	0	-24,376	-3,450	-1,258	-6,702	-31,460	-11,020	266	-11,079	-89,988	-101,068	
Korea, Rep.	-74	-41,713	-6,723	4,217	22,215	0	-946	-995	-548	-7,629	-1,622	-2,930	-2,899	-33,849	-36,748	
Malaysia	-68	-9,487	-4,935	1,283	-2,138	-1,403	0	608	3,050	-1,039	-2,404	-228	2,242	-19,003	-16,761	
Philippines	-2	-8,182	-2,506	1,097	1,357	904	-1,246	0	-464	1,435	168	619	172	-6,992	-6,820	
Singapore	-132	118	-11,374	-1,634	11,741	2,089	8,594	-1,158	0	2,716	2,078	-2,565	5,183	5,289	10,473	
Taiwan, China	-239	-58,131	-14,874	1,134	25,514	2,813	-2,419	-1,754	-4,347	0	-1,808	-3,369	-12,802	-44,677	-57,479	
Thailand	-214	-6,173	-3,049	-1,201	6,893	692	1,544	-510	1,888	851	0	-1,511	-3	-786	-790	
Vietnam	-126	3,091	809	239	-952	2,738	139	-523	2,604	3,368	1,464	0	3,798	9,053	12,851	
ASEAN	-620	-20,211	-21,227	-122	5,271	2,018	8,080	-2,192	18,937	5,454	3,022	-3,521	23,584	-28,695	-5,111	
NE Asia	-495	-4,016	-43,869	18,514	53,715	15,193	-5,296	-1,744	4,959	10,697	-11,848	-9,569	-5,479	31,720	26,241	
East Asia (12)	-1,114	-79,390	-65,096	18,102	58,986	17,211	1,768	-3,936	23,896	16,151	-10,195	-13,090	15,431	-52,138	-36,707	
EU (27)	492	71,641	20,169	4,488	28,976	16,940	3,260	3,121	4,612	4,599	4,211	2,950	23,135	142,325	165,460	
LAC (13)	1,384	110,889	34,689	5,809	69,776	14,849	13,045	-2,280	552	7,622	8,528	5,082	32,121	237,825	269,946	
World	735	102,001	-8,042	27,959	79,074	23,183	26,379	-8,233	29,602	7,801	-8,054	-4,314	64,074	204,017	268,092	
<b>Trade Intensity Index of Exports in All Goods</b>																
Cambodia	0	1.8	4.3	2.8	0.3	1.3	2.0	0.5	3.4	4.5	21.2	43.8	7.9	1.9	3.3	
China	0.1	0	8.2	1.4	2.5	4.0	1.2	1.8	1.6	3.9	1.5	1.8	1.5	2.7	2.4	
Hong Kong, China	7.1	5.3	0	0.6	2.0	1.8	1.9	2.6	3.0	5.3	1.8	0.4	2.1	3.2	2.9	
Indonesia	0.1	1.5	0.6	0	2.1	2.4	3.2	1.6	13.1	1.7	4.9	2.0	6.4	1.7	2.8	
Japan	0.2	2.7	1.3	5.1	0	2.1	2.3	4.3	1.3	1.9	3.3	3.3	2.7	1.6	1.8	
Korea, Rep.	0.4	2.3	1.1	4.1	3.9	0	1.7	1.7	1.7	1.5	1.0	1.0	1.9	2.2	2.1	
Malaysia	0.3	1.3	0.8	3.8	2.0	1.5	0	5.6	12.5	2.1	4.9	3.0	6.3	1.5	2.6	
Philippines	0.2	1.2	1.8	3.4	3.1	2.3	2.8	0	3.7	4.5	3.8	5.2	3.3	2.3	2.5	
Singapore	0.2	1.4	1.3	5.8	2.0	1.6	9.9	4.1	0	2.6	4.3	3.7	4.1	1.7	2.2	
Taiwan, China	0.0	0.8	0.8	1.0	2.6	1.4	1.0	1.6	1.4	0	0.9	1.0	1.2	1.3	1.3	
Thailand	0.7	1.1	1.1	2.9	4.2	1.3	6.0	3.2	4.6	2.2	0	3.0	3.7	2.1	2.5	
Vietnam	4.5	2.2	1.3	2.4	1.8	3.6	2.4	2.2	5.7	6.4	6.4	0	4.1	2.5	2.9	
ASEAN	0.9	2.1	1.7	5.4	3.7	2.8	7.5	5.1	9.1	4.1	6.0	5.1	7.2	2.8	3.8	
NE Asia	3.9	5.5	8.8	6.7	5.6	6.4	4.5	7.0	5.0	7.8	5.2	4.7	5.3	6.3	6.1	
East Asia (12)	3.2	4.8	7.0	7.0	5.5	5.7	6.2	7.1	7.2	7.3	6.1	5.5	6.6	5.6	5.9	
EU (27)	1.7	1.6	1.2	1.0	1.2	1.3	1.0	1.4	1.0	1.0	1.1	1.4	1.1	1.3	1.3	
LAC (13)	4.4	2.2	1.6	1.2	2.3	1.7	1.8	1.7	1.0	1.5	1.5	1.8	1.4	2.0	1.9	

Notes: EU(27) includes European Union 25 members plus new members of Bulgaria and Romania.

LAC(13) includes LAIA(11) countries plus Canada and United States.

Source: Computations based on UN COMTRADE Statistics.

Table 6: Matrix of Latin American Trade in All Goods, 2005

Partner (Importer)	Exporting Country													ANDEAN	Mercosur	LAIA(11)	NAFTA	LAC(13)
	Argentina	Bolivia	Brazil	Chile	Colombia	Ecuador	Mexico	Paraguay	Peru	Uruguay	Venezuela	Canada	USA					
	<b>Export Value in All Goods (\$ million)</b>																	
Argentina	0	264	9,912	626	47	42	672	102	54	267	18	144	4,100	425	10,281	12,004	4,916	16,248
Bolivia	380	0	579	211	50	8	37	22	155	5	5	13	218	218	985	1,451	268	1,683
Brazil	6,328	1,016	0	1,729	141	89	890	312	453	458	187	912	15,345	1,887	7,099	11,605	17,147	27,862
Chile	4,497	41	3,611	0	296	301	668	30	1,129	83	103	340	5,198	1,871	8,221	10,759	6,206	16,297
Colombia	361	179	1,405	347	0	471	1,548	2	347	14	1,013	369	5,415	2,010	1,780	5,686	7,333	11,470
Ecuador	265	3	644	341	1,324	0	309	7	295	10	296	132	1,979	1,919	926	3,495	2,420	5,606
Mexico	1,158	20	4,062	1,582	611	58	0	5	332	139	470	2,690	120,048	1,491	5,363	8,436	122,738	131,174
Paraguay	509	22	960	40	2	1	14	0	0	56	4	8	896	29	1,525	1,609	918	2,512
Peru	599	126	932	725	710	869	345	20	0	37	151	218	2,289	1,856	1,588	4,514	2,853	7,021
Uruguay	862	2	848	72	7	3	66	451	7	0	1	20	354	20	2,161	2,318	439	2,692
Venezuela	510	159	2,214	359	2,098	122	1,289	9	299	33	0	567	6,408	2,677	2,767	7,091	8,264	14,066
USA+Canada	4,865	428	24,657	7,317	9,150	5,001	188,072	58	6,279	876	24,645	302,204	211,417	45,503	30,457	271,350	701,693	784,971
ANDEAN	2,114	466	5,773	1,983	4,182	1,470	3,528	60	1,095	99	1,466	1,300	16,310	8,680	8,046	22,237	21,138	39,847
MERCOSUR	7,699	1,305	11,720	2,467	197	135	1,642	865	514	781	211	1,084	20,695	2,361	21,066	27,536	23,421	49,314
LAIA (11)	15,467	1,832	25,166	6,032	5,286	1,964	5,838	960	3,070	1,103	2,249	5,414	162,250	14,402	42,696	68,967	173,503	236,632
NAFTA	6,023	448	28,719	8,899	9,761	5,059	188,072	63	6,611	1,015	25,115	304,894	331,465	46,994	35,820	279,786	824,431	916,145
LAC (13)	20,333	2,260	49,823	13,349	14,436	6,965	193,910	1,018	9,349	1,979	26,894	307,618	373,667	59,905	73,153	340,317	875,196	1,021,602
World	40,106	2,797	116,129	38,596	21,190	9,869	214,207	1,626	17,114	3,405	55,487	360,136	904,339	106,459	161,265	520,527	1,478,683	1,785,002
	<b>Share of Intra-Regional Trade in All Goods from Importer (%)</b>																	
Argentina	0	1.6	61.0	3.9	0.3	0.3	4.1	0.6	0.3	1.6	0.1	0.9	25.2	2.6	63.3	73.9	30.3	100.0
Bolivia	22.6	0	34.4	12.5	3.0	0.5	2.2	1.3	9.2	0.3	0.3	0.8	13.0	13.0	58.6	86.2	16.0	100.0
Brazil	22.7	3.6	0	6.2	0.5	0.3	3.2	1.1	1.6	1.6	0.7	3.3	55.1	6.8	25.5	41.7	61.5	100.0
Chile	27.6	0.3	22.2	0	1.8	1.8	4.1	0.2	6.9	0.5	0.6	2.1	31.9	11.5	50.4	66.0	38.1	100.0
Colombia	3.1	1.6	12.2	3.0	0	4.1	13.5	0.0	3.0	0.1	8.8	3.2	47.2	17.5	15.5	49.6	63.9	100.0
Ecuador	4.7	0.1	11.5	6.1	23.6	0	5.5	0.1	5.3	0.2	5.3	2.4	35.3	34.2	16.5	62.3	43.2	100.0
Mexico	0.9	0.0	3.1	1.2	0.5	0.0	0	0.0	0.3	0.1	0.4	2.1	91.5	1.1	4.1	6.4	93.6	100.0
Paraguay	20.3	0.9	38.2	1.6	0.1	0.0	0.6	0	0.0	2.2	0.2	0.3	35.6	1.2	60.7	64.0	36.5	100.0
Peru	8.5	1.8	13.3	10.3	10.1	12.4	4.9	0.3	0	0.5	2.2	3.1	32.6	26.4	22.6	64.3	40.6	100.0
Uruguay	32.0	0.1	31.5	2.7	0.3	0.1	2.4	16.8	0.2	0	0.1	0.7	13.1	0.7	80.3	86.1	16.3	100.0
Venezuela	3.6	1.1	15.7	2.5	14.9	0.9	9.2	0.1	2.1	0.2	0	4.0	45.6	19.0	19.7	50.4	58.8	100.0
USA+Canada	0.6	0.1	3.1	0.9	1.2	0.6	24.0	0.0	0.8	0.1	3.1	38.5	26.9	5.8	3.9	34.6	89.4	100.0
ANDEAN	5.3	1.2	14.5	5.0	10.5	3.7	8.9	0.2	2.7	0.2	3.7	3.3	40.9	21.8	20.2	55.8	53.0	100.0
MERCOSUR	15.6	2.6	23.8	5.0	0.4	0.3	3.3	1.8	1.0	1.6	0.4	2.2	42.0	4.8	42.7	55.8	47.5	100.0
LAIA (11)	6.5	0.8	10.6	2.5	2.2	0.8	2.5	0.4	1.3	0.5	1.0	2.3	68.6	6.1	18.0	29.1	73.3	100.0
NAFTA	0.7	0.0	3.1	1.0	1.1	0.6	20.5	0.0	0.7	0.1	2.7	33.3	36.2	5.1	3.9	30.5	90.0	100.0
LAC (13)	2.0	0.2	4.9	1.3	1.4	0.7	19.0	0.1	0.9	0.2	2.6	30.1	36.6	5.9	7.2	33.3	85.7	100.0
World	2.2	0.2	6.5	2.2	1.2	0.6	12.0	0.1	1.0	0.2	3.1	20.2	50.7	6.0	9.0	29.2	82.8	100.0

<b>Cont. Table 6</b>																		
<b>Partner (Importer)</b>	Argentina	Bolivia	Brazil	Chile	Colombia	Ecuador	Mexico	Paraguay	Peru	Uruguay	Venezuela	Canada	USA	ANDEAN	Mercosur	LAIA(11)	NAFTA	LAC(13)
	<b>Trade Balance in All Goods (\$ million)</b>																	
Argentina	0	-127	3,324	-4,178	-364	-304	-631	-560	-671	-519	-386	-230	-472	-1,852	2,245	-4,416	-1,332	-5,118
Bolivia	80	0	-593	173	-142	5	7	12	47	3	-205	-7	-75	-295	-497	-612	-75	-695
Brazil	-4,297	503	0	-2,069	-1,242	-596	-4,324	-547	-575	-366	-1,808	-1,685	-9,091	-3,718	-5,211	-15,321	-15,100	-26,097
Chile	3,825	-122	1,838	0	-81	-109	-1,086	-9	514	14	-226	-1,033	-1,467	-24	5,668	4,558	-3,587	2,058
Colombia	304	121	1,253	3	0	-912	873	-1	-426	12	-1,384	-112	-3,431	-2,601	1,568	-157	-2,669	-3,700
Ecuador	202	-9	548	70	795	0	203	7	-619	8	141	37	-3,780	308	764	1,346	-3,539	-2,397
Paraguay	419	-31	3,185	820	-1,146	-245	0	-12	-32	89	-1,074	-9,357	-50,146	-2,528	3,681	1,973	-59,502	-57,530
Peru	54	-1	631	-77	-9	-4	5	0	-82	36	-31	-4	844	-126	720	523	845	1,363
Uruguay	545	-26	456	-382	360	504	-100	19	0	32	-108	-903	-2,831	730	1,051	1,299	-3,835	-2,436
Venezuela	303	-4	338	-29	-21	-49	-197	388	-40	0	-45	-88	-378	-158	1,030	645	-664	179
USA+Canada	474	120	1,925	223	878	-328	505	1	-230	-211	0	-943	-27,556	440	2,188	3,356	-27,994	-25,143
ANDEAN	247	87	10,131	2,203	2,727	3,041	62,930	-58	3,849	594	17,509	121,607	-76,375	27,212	10,914	103,258	108,161	148,490
MERCOSUR	1,605	205	3,589	86	1,892	-731	1,488	37	-1,229	-157	-1,556	-1,928	-37,673	-1,418	5,074	5,231	-38,112	-34,370
LAIA (11)	-3,940	372	4,293	-6,353	-1,636	-954	-5,147	-719	-1,367	-850	-2,269	-2,007	-9,097	-5,854	-1,216	-18,570	-16,251	-29,674
NAFTA	1,910	425	12,905	-5,446	-971	-2,038	-4,745	-703	-2,114	-905	-5,126	-14,324	-98,383	-9,825	13,207	-6,808	-117,453	-119,516
LAC (13)	666	56	13,316	3,023	1,581	2,795	62,930	-71	3,817	682	16,435	112,250	126,521	24,684	14,594	105,231	48,659	90,960
World	2,157	511	23,037	-3,243	1,756	1,002	58,185	-762	1,735	-311	12,383	107,282	174,758	17,387	24,121	96,450	-9,291	28,973
	11,418	454	39,693	8,738	-14	261	-7,612	-1,472	4,612	-474	33,639	45,700	766,390	38,952	49,165	89,244	-728,301	-631,446
	<b>Trade Intensity Index of Exports in All Goods</b>																	
Argentina	--	37.0	33.4	6.4	0.9	1.7	1.2	24.5	1.2	30.7	0.1	0.2	1.8	1.6	25.0	9.0	1.3	3.6
Bolivia	46.2	--	24.3	26.6	11.5	4.0	0.8	67.3	44.2	6.6	0.5	0.2	1.2	10.0	29.8	13.6	0.9	4.6
Brazil	22.4	51.6	--	6.4	0.9	1.3	0.6	27.3	3.8	19.1	0.5	0.4	2.4	2.5	6.2	3.2	1.6	2.2
Chile	41.0	5.3	11.4	--	5.1	11.2	1.1	6.6	24.1	8.9	0.7	0.3	2.1	6.4	18.6	7.6	1.5	3.3
Colombia	4.8	34.2	6.5	4.8	--	25.6	3.9	0.5	10.8	2.1	9.8	0.5	3.2	10.1	5.9	5.8	2.7	3.4
Ecuador	7.7	1.3	6.5	10.4	73.4	--	1.7	5.1	20.3	3.6	6.3	0.4	2.6	21.2	6.7	7.9	1.9	3.7
Mexico	1.6	0.4	2.0	2.3	1.6	0.3	--	0.2	1.1	2.3	0.5	0.4	7.5	0.8	1.9	0.9	4.7	4.1
Paraguay	38.1	23.8	24.8	3.1	0.3	0.2	0.2	--	0.1	49.3	0.2	0.1	3.0	0.8	28.4	9.3	1.9	4.2
Peru	14.4	43.3	7.7	18.0	32.2	84.6	1.5	11.7	--	10.5	2.6	0.6	2.4	16.8	9.5	8.3	1.9	3.8
Uruguay	50.8	1.4	17.3	4.4	0.8	0.8	0.7	656.0	0.9	--	0.1	0.1	0.9	0.4	31.7	10.5	0.7	3.6
Venezuela	6.1	27.0	9.1	4.4	47.2	5.9	2.9	2.7	8.3	4.7	--	0.8	3.4	12.0	8.2	6.5	2.7	3.8
USA+Canada	0.9	1.2	1.6	1.5	3.3	3.9	6.8	0.3	2.8	2.0	3.4	6.5	1.8	3.3	1.5	4.0	3.7	3.4
ANDEAN	8.7	27.5	8.2	8.5	32.6	24.6	2.7	6.1	10.6	4.8	4.4	0.6	3.0	13.5	8.2	7.0	2.4	3.7
MERCOSUR	18.5	45.1	9.7	6.2	0.9	1.3	0.7	51.4	2.9	22.2	0.4	0.3	2.2	2.1	12.6	5.1	1.5	2.7
LAIA (11)	10.4	17.7	5.9	4.2	6.8	5.4	0.7	16.0	4.9	8.8	1.1	0.4	4.9	3.7	7.2	3.6	3.2	3.6
NAFTA	1.3	1.4	2.1	2.0	4.0	4.4	7.6	0.3	3.3	2.6	3.9	7.3	3.2	3.8	1.9	4.6	4.8	4.4
LAC (13)	4.4	7.0	3.7	3.0	5.9	6.1	7.8	5.4	4.7	5.0	4.2	7.4	3.6	4.9	3.9	5.7	5.1	5.0

Source: Computations based on COMTRADE Statistics.

Yet another way to examine the characteristics of recent regional trade agreements is to note that one of the important motives of the so-called “New Regionalism”, particularly for smaller economies, is to design rules to attract more foreign direct investment and to strengthen institutions in order to participate in global and regional production sharing (Ethier 1998, Salazar-Xirinachs 2005). Thus one way to evaluate the performance of FTAs of East Asian and Latin American countries is to examine the competitiveness of East Asian and Latin American countries in items such as components and parts, using the revealed comparative advantage (RCA) index. The index is defined as:

$$RCA_{jk} = \frac{X_{jk} / X_k}{X_{wj} / X_w}$$

where  $j$  indicates the product value and  $k$  home country.  $X_{jk}$  and  $X_{wk}$  represent the product value of  $j$  exported by country  $k$  and the world;  $X_k$  and  $X_w$  are total exports of  $j$  by country  $k$  and the world. If the index has a value greater than one, country  $k$  has a comparative advantage in the production of product  $j$ . If the index has a value smaller than one, the industry of the country has a comparative disadvantage.

Suppose we go further and differentiate the RCA index for exports from that for imports. When the RCA index is greater than 1 for exports of components and parts,<sup>8</sup> we can reasonably argue that the economy has a comparative advantage in “processing”. When the RCA index is greater than 1 for imports, we say that the economy has comparative advantage in “assembly”. The RCA indices for East Asian and Latin American imports and exports of parts and components for various years are shown in Table 7 and Table 8.

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<sup>8</sup> The list of products that are classified as components and parts is available upon request. The list is compiled from the UN COMTRADE statistics by the authors.

**Table 7: The Percentage of Parts and Components Products with Comparative Advantage in East Asian Countries**

Country	Exports - Production Operations ( % of Products with RCA > 1)			Imports - Assembly Operations ( % of Products with RCA > 1)		
	1985	1995	2005	1985	1995	2005
Cambodia	..	..	2.7	..	..	6.7
China	12.0	20.0	30.7	40.0	44.0	34.7
Hong Kong, China	25.3	22.7	33.3	41.3	44.0	36.0
Indonesia	0.0	8.0	9.3	58.7	50.7	42.7
Japan	40.0	46.7	42.7	6.7	8.0	16.0
Korea Rep.	10.7	16.0	26.7	28.0	37.3	21.3
Malaysia	8.0	13.3	20.0	52.0	36.0	37.3
Philippines	5.3	4.0	17.3	34.7	36.0	25.3
Singapore	18.7	20.0	34.7	36.0	41.3	41.3
Taiwan, China	34.7	22.7	34.7	40.0	44.0	21.3
Thailand	10.7	20.0	24.0	33.3	41.3	29.3
Vietnam	..	1.3	12.0	..	4.0	25.3
Average ASEAN	8.5	11.1	17.1	42.9	34.9	29.7
Average NE Asia	24.5	25.6	33.6	31.2	35.5	25.9
Average above all East Asia	16.5	17.7	24.0	37.1	35.2	28.1
Average above excluding Japan	13.9	14.8	22.3	40.4	37.9	29.2
Memo Items: Comparators						
Canada	17.3	20.0	24.0	76.0	52.0	53.3
United States	61.3	64.0	54.7	37.3	38.7	33.3
Germany	70.7	65.3	62.7	45.3	36.0	50.7
Mexico	12.0	22.7	29.3	66.7	41.3	38.7

Notes: Percentages based on the 75 products of parts and components from textiles & clothing and machinery & equipment at SITC 4/5-digit level in Revision 2.

Due to the missing data, the 1995 data for Vietnam is replaced by 1997.

Source: Computations based on UN COMTRADE Statistics.

From Table 7, it is clear that East Asian revealed comparative advantage in processed exports of components and parts has been gaining over the years, starting way back from 1985. The percentage of products that the East Asian economies have comparative advantage in assembly has declined over time. The results for Latin America are given in Table 8.

**Table 8: The Percentage of Parts and Components Products with Comparative Advantage in Latin American Countries**

Country	Exports - Production Operations ( % of Products with RCA > 1)			Imports - Assembly Operations ( % of Products with RCA > 1)		
	1985	1995	2005	1985	1995	2005
Argentina	1.3	9.3	10.7	32.0	36.0	38.7
Bolivia	0.0	0.0	2.7	44.0	22.7	24.0
Brazil	6.7	14.7	18.7	28.0	34.7	49.3
Chile	1.3	0.0	0.0	40.0	33.3	26.7
Colombia	4.0	4.0	4.0	30.7	34.7	32.0
Ecuador	0.0	1.3	0.0	45.3	34.7	25.3
Mexico	17.3	22.7	29.3	62.7	41.3	38.7
Paraguay	0.0	0.0	1.3	29.3	17.3	13.3
Peru	2.7	1.3	1.3	48.0	34.7	33.3
Uruguay	4.0	4.0	5.3	14.7	26.7	22.7
Venezuela	0.0	0.0	0.0	57.3	37.3	36.0
United States	61.3	64.0	54.7	37.3	38.7	33.3
Canada	17.3	20.0	24.0	76.0	52.0	53.3
Average ANDEAN	1.3	1.3	1.6	45.1	32.8	30.1
Average MERCOSUR	3.0	7.0	9.0	26.0	28.7	31.0
Average above Latin America (LAIA)	3.4	5.2	6.7	39.3	32.1	30.9
Average LAIA excluding Mexico	2.0	3.5	4.4	36.9	31.2	30.1
Average NAFTA	32.0	35.6	36.0	58.7	44.0	41.8
Average above all countries (LAC)	8.9	10.9	11.7	41.9	34.2	32.8
Memo Items: Comparators						
China	12.0	20.0	30.7	40.0	44.0	34.7
Korea Rep.	10.7	16.0	26.7	28.0	37.3	21.3
Malaysia	8.0	13.3	20.0	52.0	36.0	37.3
East Asia (12) average	16.5	17.7	24.0	37.1	35.2	28.1

Notes: Percentages based on the 75 products of parts and components from textiles & clothing and machinery & equipment at SITC 4/5-digit level in Revision 2.

Due to the missing data, the 1985 data for Mexico is used 1986.

Source: Computations based on UN COMTRADE Statistics.

Except for Mexico and, in a lesser extent, Brazil, that show a rising comparative advantage in processing, other Latin American economies have not shown significant increases in the percentage of components and parts that they have comparative advantage. Our result from this section is as follows:

*East Asia has more intense integration with itself compared to the case of Latin America. East Asia also has a growing comparative advantage in the processing of exports of components and parts.*

*Notwithstanding the recent regionalism in East Asia and the absence of a regional trade arrangement for the whole region, intra-regional-trade has expanded rapidly and has been deeper compared to Latin America.*

#### **4. A Simple Bargaining Analysis of the Implementation of Regional Trade Agreements**

In our discussions of East Asian regional as well as Latin American regional agreements, it is clear that trade policies as well as regional trade agreements often serve at least two purposes. One on hand, trade and trade agreements are about promoting economic growth and development. This objective is thus economic. One the other hand, trade agreements are often done with foreign policy goals in mind. For example, analysts often point out that both Japan and China are jockeying for positions of political and diplomatic influence when they attempt to form bilateral trade deals in Asia, including their interest in ASEAN. Similarly, Brazil is often seen to be using their position in MERCUSOR to thwart the power of the United States in Latin America (Jose M. Salazar-Xirinachs 2005). Indeed, in most countries, trade policy formulations and implementations include representatives of foreign policy interests (Barfield 2005). Furthermore, within economic interests, as we can see from our discussion of the early form of trade agreements in Latin America, some trade agreements are inward-looking, while others are outward-oriented. Thus implementations of regional trade agreements will depend on the internal bargaining of various objectives.

Suppose we take the example of how trade policies are implemented in a particular East Asian country, say Japan. Japan's trade policy formulation and implementation are the

responsibilities are several Ministries, in particular, The Ministry of Foreign Affairs (MOFA) and The Ministry of Economy, Trade and Industry (METI), with the overall coordination responsibility being shouldered by the Cabinet (WTO 2007). When the WTO was established, Japan was not a member of any of the then existing 62 formal regional trade agreements (Sapir 1998, Mavroidis 2005). Japan now has several formal bilateral trade agreements, including agreements with Singapore, Mexico and Malaysia.

According to Aoki (1988), policy implementation and formulation (including trade policies) in Japan can be seen as a bargaining of the various Ministries. Furthermore, certain bureaus of each Ministry (*genkyoku*) maintain contact with their constituents and the Ministry can be understood to be maximizing a weighted sum of the interests of its constituents as well as the national interest. The argument for this view is that when the bureaucrats from each Ministry retire, they often will “descend from the heaven” (*amakudari*) and obtain high positions in the private sector, usually in the constituents’ industries. While this aspect of industry-government linkage has been weakened in recent years, nonetheless it still exists and is a strong reason for the Ministries to pay attention to the interests of their constituents. At the same time, each Ministry cannot stray too often and too far from the national interest or it risks the loss of reputation within the government and among the public. Generally MOFA can be viewed as paying particular attention to the diplomatic and security interests of Japan, while METI is viewed as paying special attention to the economic and international trade interests of the country. The implicit bargaining of these two Ministries, together with the participation and coordination of other government entities, will decide how trade policies and regional trade agreements will be implemented.

To simplify our analysis, suppose trade policy formulation is represented in a model of generalized Nash bargaining game. The policymaker is the Nashian arbitrator maximizing a weighted sum of the economic and foreign policy interests (the interests of MOFA and METI, respectively). We further assume for simplicity the overall national interests can be subsumed within the economic and the foreign policy objectives. Then we can write down the maximization of the national objective  $N$  of a country, say Japan, is:

$$\text{Max}_t \quad N = (E - E^0)^a (F - F^0)^b$$



where  $N$  is the national objective,  $E$  represents the economic interest,  $F$  is the foreign policy goal,  $a$  is the bargaining power of the economic interest (as ultimately represented in the implementation of the regional trade agreement by economic agents such as traders, exporters, retailers which import cheaper import goods, etc), and  $b$  is the bargaining power of the foreign policy establishments.  $E^0$  and  $F^0$  are the respective threat points of the economic and foreign policy interests. There may be a formally agreed (via a de jure trade treaty) trade instrument  $T$ , but the *effective* trade policy to be implemented in each country is actually  $t$ , the policy instrument to be bargained by various groups within each country. This can be something transparent such as foreign investment policy or a more opaque instrument such as a trade facilitation policy (custom procedure, technical standards, etc.).

We can further assume that within the economic interests, the interests of trade agreement implementations can be divided into two camps: the interests of the inward-looking group  $M$  and the interests of the outward-looking group  $X$ . The three parties form the negotiated national objective function of:

$$N = (M - M^0)^{am} (X - X^0)^{ax} (F - F^0)^b$$

where  $M^0$  and  $X^0$  are the respective threat points for the inward-looking group and the outward-looking group. For example, in the earlier periods, when Japan's METI was Ministry of International Trade and Industry (MITI), the powerful agency that was focused on industrial policy implementations, the outward-looking economic interests can be interpreted as the interests of the exporters, while the inward-looking economic interests represent the constituents who wanted to restrict imports and restrict inward direct investment (Noland and Pack 2003). All the interests of the parties are related to the effectively implemented trade policy instrument  $t$ . It is assumed that  $M$  increases with an increase in  $t$  (i.e. the interests of the inward-looking group rise with a rise in protection).  $X$  decreases with a rise in protection, while  $F$  can vary for a country located in different regions at different periods. In East Asia, foreign policy interests tend to be more pro-trade, so there is a sense that  $F$  rises with a lower  $t$ . In other cases, a component of foreign policy may be to go against open trade, particularly U.S.-led regional trade agreements. In that case,  $F$  rises with an increase in protection, at least for some range of  $t$ .

In essence, we assume that if there is a formal regional trade contract which establishes the formal trade policy instrument  $T$ , it is an *incomplete contract*. An incomplete trade contract is one where it cannot specify all contingencies. Regional trade dispute settlement can help, but even there the process is slow and can be inconsistent. Thus national governments have the leeway to implement trade instruments to various degrees of openness. In effect, we assume that the implemented trade policy,  $t$ , can be higher or lower. The implementation process is decided by internal bargaining of various groups within the country. As is well-known the generalized Nash bargaining formulation can be mathematically derived from a more detailed bargaining process (Binmore, Rubinstein and Wolinsky 1986). The bargaining power of each party depends on how patient the party is able to be while waiting out an impasse, how averse the party is to the risk of a collapse of an agreement and what alternative is available to the party in the event that the bargaining breaks down. Given that East Asia already has a deep degree of trade integration via the market, we can argue that the bargaining power of the outward-oriented group is high. Furthermore, given that the foreign policy establishments in East Asia tend to be pro-exports (as e.g. under MOFA), an active role played by the foreign policy interests will tend to coincide with the outward-oriented interests. Assuming that we have a unique maximum for  $N$  and that  $t^*$  solves the maximization, we have

$$\begin{aligned} dN/dt &= 0 \text{ or} \\ \arg \max N &= t^* \end{aligned}$$

Furthermore, we have  $dt^*/d(am) > 0$ ,  $dt^*/d(ax) < 0$ . For an East Asian economy where foreign interests generally are pro-trade,  $dt^*/db < 0$ . For a country whose foreign policy interests are anti-trade, we have  $dt^*/db > 0$ .

In internal deliberations concerning how the trade agreement should be implemented, the various parties attempt to reach an agreement. These three sets of interests may go against each other and the internal equilibrium may break down. The threat points and the bargaining power of each party will determine which direction the implementation of the regional trade agreement may go.<sup>9</sup> For example, it may be to the nation's outward-oriented economic advantage to be welcoming foreign direct investment. However to the inward-looking group and to some foreign policy analysts, this may represent a loss of influence and sovereignty.

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<sup>9</sup> For an application to trade negotiations, see Fung, Iizaka, Lin and Ng (2004).

Even for the case of Japan, liberalization of inward foreign direct investment is effectively a relatively recent event (Noland and Pack 2003).

If the economy is already fairly integrated with other regional trading partners via the market first, there is a thick group of outward-looking economic interests (such as exporters, traders, shippers, etc) that may raise the bargaining power of the outward-looking open-trade economic constituency (an increase in  $ax$ ). This will tilt the implementation of the trade agreement in favor of pursuing further liberalization in response to the correct market signal. If however, there is only limited market integration and the inward-looking and certain types of foreign policy interests dominate (an increase in  $am$  and an increase in  $b$  of the protectionist foreign policy interests), then the regional agreement will in actuality not be implemented for economic integration. Instead it will be used mainly as a tool for import-substitution and nationalistic foreign policy objectives. This simple analysis can thus be used to highlight why developing first a network of traders and exporters may help generate a more outward-looking economically friendly outcome.<sup>10</sup> This may help explain why by integrating via markets and by pursuing policies that are generally business-friendly and foreign direct investment-friendly (even though formal regional trade agreements had been absent), East and Southeast Asia has been able to generate a deeper degree of regional integration in practice.

Our result from this section can be summarized as:

*Integrating via the markets first and engaging in formal trade agreements later seem to be the better economic and trade policy sequence. One reason this is the case is because this sequence can enhance the internal bargaining power of the outward-looking trade interests first, which may tilt the implementation of the formal regional trade agreement to be more market-friendly.*

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<sup>10</sup> A much more familiar argument for having a formal trade agreement when there is already substantially a lot of trade is that this is less likely to generate trade diversion. For details, see e.g. Winters (1999).

## 5. Conclusion

In this paper, we examine the two channels of regional integration: integration of markets vs. integration by agreements. Since East Asia and Latin America are two regions where preferential trade agreements have proliferated in recent years, we utilize the experiences of these two areas to illustrate our results. We have *four* related results in this paper. First, East Asia started their integration by primarily using the markets, then by the 1990s, the region started to turn to more formal agreements. Complementary policies in the drive for integration via the markets include business-friendly and FDI-friendly policies as well as domestic policies such as improvement of the infrastructure. Latin America, on the other hand, has relied mainly on formal, de jure regional agreements for integration. Second, using a variety of indicators, it seems that at least in terms of the extent of intra-regional integrations and in terms of advancing comparative advantage in the processing of components and parts, East and Southeast Asia has been more successful. Third, if the main objective is regional trade integration, then it seems that the proper sequencing of the two forms of integration is first to develop integration via the markets before engaging in more formal agreements. Lastly, an argument in favor of this sequence is that by developing the lobbying clout of the outward-looking economic and trade interests first, this will enhance the internal bargaining power of the outward-oriented constituency in the internal bargaining of trade policy, thereby tilting the implementation of the regional trade agreement to be more in line with the market signals.

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