

## Part II

# Regionalism and multilateralism – friends or foes?

# Chapter II

## PREFERENTIAL TRADE IN ASIA AND THE PACIFIC: TRENDS AND PROSPECTS FOR MULTILATERALIZATION

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### Introduction

There are two broad sources of preferential trade. It can be based on trade concessions extended unilaterally to selected trading partners without any expectations of reciprocity. Generalized System of Preferences (GSP) schemes for developing countries belong to this type of preferential trade. Another source arises from the reciprocal preferential trade agreements also known as regional trade agreements (RTAs).<sup>1</sup> The use of trade by most Asian economies as a means of achieving fast growth and development has been achieved with little reliance on preferential trade. Participation by the Asia-Pacific economies (members of ESCAP)<sup>2</sup> in the global (GATT/WTO) trading system from 1948 to 2007 is illustrated in figure 1. Membership in GATT/WTO grew slowly from the initial six to the current 31 members over several decades.<sup>3</sup> On the other hand, the number of preferential trade agreements (PTAs) established by those countries exploded in a relatively short period, from less than five in the late 1970s to more than 100 effective agreements in mid-2007.

As figure 2 shows, the proliferation of regionalism among the Asia-Pacific countries did not adversely affect exports of the Asia-Pacific GATT/WTO members, which make up a (slowly) growing share of total GATT/WTO exports to the world. However, figure 3

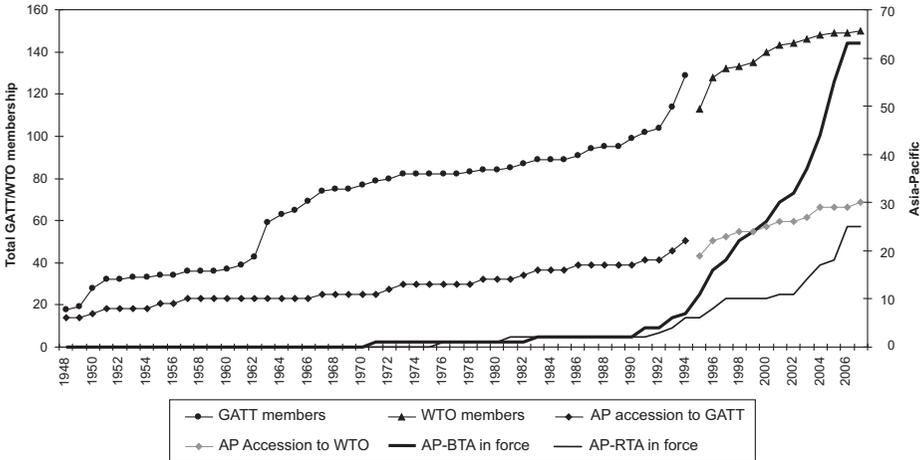
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<sup>1</sup> The terms “preferential trade agreements” (PTAs), “preferential trade” and “preferential trade liberalization” are loosely used to refer to a wide variety of agreements that are also classed as “regional trade agreements” (RTAs). It should be noted that members of RTAs are not always in geographical proximity. The term “regional integration” is used in this chapter as a synonym for RTAs or PTAs.

<sup>2</sup> ESCAP has 62 members and associate members, 58 of which are regional and four of which are non-regional (France, the Netherlands, the United Kingdom of Great Britain and Northern Ireland, and the United States of America). In this chapter, “Asia-Pacific” refers to the regional members. More information on ESCAP membership is available at <<http://www.unescap.org/about/member.asp>>.

<sup>3</sup> When GATT was officially born in 1947, it had 23 founding members (“contracting parties”). The group included Australia, Belgium, Brazil, Burma (Myanmar), Canada, Ceylon, Chile, the former Republic of China, Cuba, Czechoslovakia, France, India, Lebanon, Luxembourg, Netherlands, New Zealand, Norway, Pakistan, Southern Rhodesia, Syrian Arab Republic, South Africa, the United Kingdom and the United States. The countries from the Asia-Pacific region that have most recently acceded to GATT are Tonga and Viet Nam.

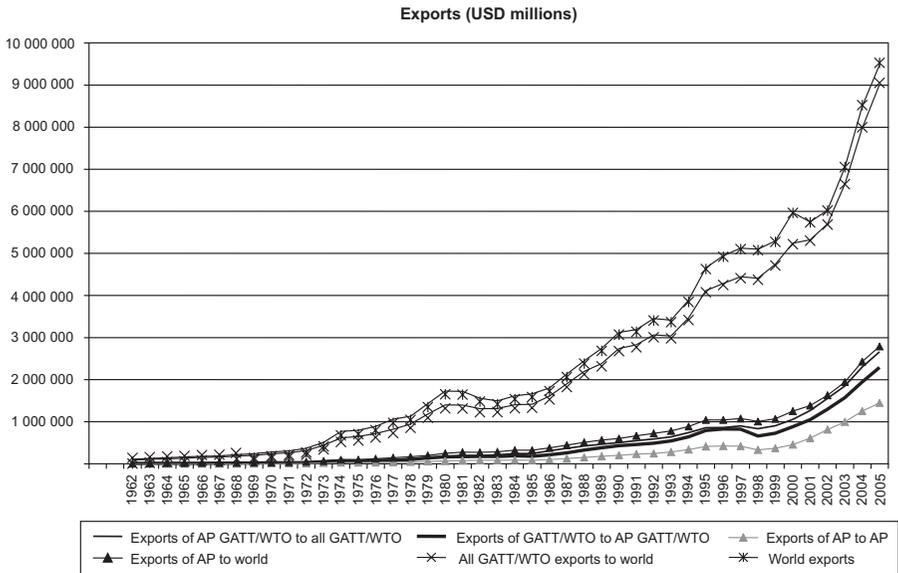
**Figure 1. Participation by Asia-Pacific economies in GATT/WTO and PTAs**



*Source:* Membership in GATT/WTO extracted from information provided on the WTO website ([http://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/org6\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm)); membership in PTAs is taken from APTIAD (<http://www.unescap.org/tid/aptiad/>).

*Note:* AP = Asia-Pacific.

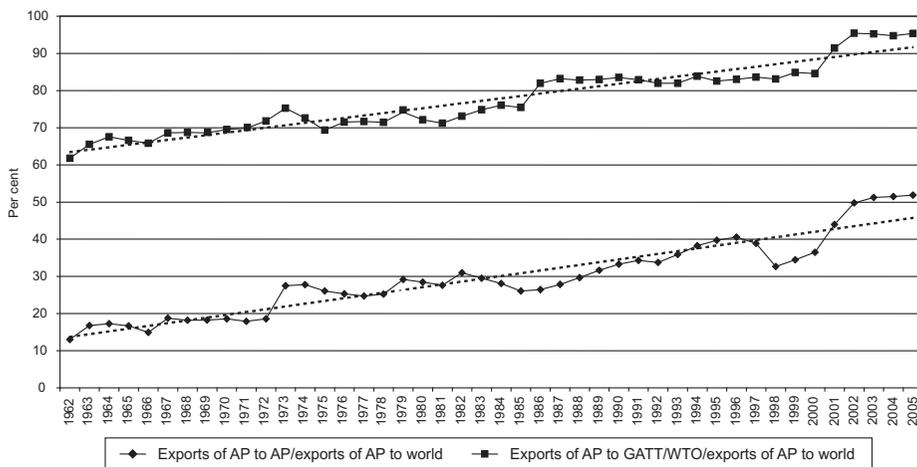
**Figure 2. Exports by world, GATT/WTO and Asia-Pacific GATT/WTO members**



*Source:* Calculated based on COMTRADE data downloaded from WITS, and membership from WTO.

*Note:* Asia-Pacific (AP) GATT/WTO include only regional members of ESCAP with full membership in GATT or WTO in the observed years.

**Figure 3. Asia-Pacific exports – looking more towards the region**



Source: Calculated based on COMTRADE data downloaded from WITS.

shows that exports from the Asia-Pacific GATT/WTO members to all GATT/WTO members and to the region, as a share of their exports to the world, is rising although not at the same pace. It appears that intraregional exports have been growing slightly faster than exports to WTO members since the establishment of WTO. Although this difference is very small, it coincides with the obvious shift in their policies towards PTAs (which is captured by exponential increase in the number of PTAs shown in figure 1). It cannot be denied that since 1995 the Asia-Pacific economies, traditionally supporters of multilateralism, have embraced PTAs as a basic trade policy option. According to data in the Asia-Pacific Preferential Trade and Investment Agreements Database (APTIAD), in 2005-2006 alone, these economies signed or opened official negotiations on more than 40 various agreements.

This chapter assesses various dimensions of preferential trade in the region. Section A first offers some facts and figures on regionalism in Asia and the Pacific. Section B provides more detail on the architecture of PTAs. In particular, it examines the scheduling approach, the extent of liberalization, types of barriers tackled, rules of origin and sectoral coverage. As one and perhaps most feasible ways of moving towards multilateralization of PTAs, section C considers the possibility of the geographical consolidation of many Asian PTAs into the so-called “Pan-Asian Free Trade Area” (PAFTA). Finally, section D closes with a non-exhaustive list of directions of policy research that might offer useful guidance to policymakers in this area.

## **A. Facts and figures on PTAs in Asia and the Pacific**

The status of regionalism, including the number of agreements under implementation and their notification, is given in table 1. As of mid-2007, 91 trade agreements that include at least one member from Asia-Pacific (ESCAP region) were in force, and a further 11

**Table 1. Status of regionalism in Asia and the Pacific**

	Total	BTA total	BTA	BTA x-cont	BTA c-b	RTA total	RTA	RTA x-cont	RTA b-b	Other
In force	91	64	50	14	13	14	11	2	0	1
Pending ratification	11	7	5	2	2	2	0	2	0	0
Under negotiation	31	28	19	9	2	1	0	1	0	0
Total notified	62	47	39	8	6	9	7	0	1	1
Art. XXIV GATT	31	27	25	2	2	2	2	0	0	0
Art. XXIV GATT and/or Art. V GATS	20	17	11	6	2	1	0	0	1	0
Enabling Clause	11	3	3	0	2	6	5	0	0	1

Source: APTIAD, 2007 (July).

were waiting for the completion of the ratification process to become effective. At the same time, the number of agreements under negotiation in APTIAD amounts to just over 30 because the database tracks only agreements with officially opened negotiations. Most of the agreements recorded as under negotiation are also between two countries, but almost one third include a partner from another geographical region.

Most of the effective agreements (as of September 2007) and those pending ratification (64) are of bilateral scope,<sup>4</sup> either between two countries in the region or globally. The group of agreements between a country and another regional trade agreement is relatively large but mostly based on activities of the ASEAN Free Trade Area (AFTA) as the trading bloc (13 effective agreements in this group). There is one other agreement, the Global System of Trade Preferences among Developing Countries (GSTP). This leaves 13 regional trade agreements, two of which include members outside the region.

The WTO discipline on RTAs (and previously GATT) requires members to be transparent about their use of trade preferences and thus they are required to notify trade agreements they negotiate. The WTO notification process recognizes free trade areas and customs unions as types of regional trade agreements that qualify under Article XXIV of GATT. All other agreements that do not qualify for notification under Article XXIV of GATT fall into "partial scope agreements" in the area of goods liberalization and can be notified only under legal cover of the Enabling Clause, paragraph 2(c). The fourth type, economic integration agreements, is reserved for liberalization in services area, to be

<sup>4</sup> Zhai (2006) commented that bilateral trade agreements (BTAs) were preferred because of their lesser costs in terms of negotiation and enforcement efforts. While this might hold true for every individual member of BTAs, the resulting costs of all BTAs might easily be higher compared with all RTAs. Bonapace (oral communication) argues that this could be because of the lack of "peer pressure" as well as institutional framework that is often missing from BTAs but built into many RTAs. Feridhanusetyawan (2005) held that the faster rate of increase in BTAs than in RTAs (plurilateral agreements) contributed to a complexity of the picture, as many of those BTAs arose "within and across different regional agreements".

**Table 2. Structure in terms of types of agreements**

	BTA	BTA x-cont	BTA c-b	RTA	RTA x-cont	Other	Total
Free trade agreement	44	8	4	4	1	0	<b>61</b>
Customs union	0	0	1	1	0	0	<b>2</b>
Preferential trade agreement	3	2	0	4	0	1	<b>10</b>
Framework agreement	3	4	8	2	1	0	<b>18</b>
<b>Total</b>	<b>50</b>	<b>14</b>	<b>13</b>	<b>11</b>	<b>2</b>	<b>1</b>	<b>91</b>

Source: APTIAD, 2007.

Notes: x-cont = cross-continental  
c-b = country-bloc

notified under Article V of General Agreement on Trade in Services (GATS). Since, in practice, the taxonomy of trade agreements still needs to be harmonized with the one adopted by WTO (see table 2), the record of notification in APTIAD jointly presents notifications under Article XXIV of GATT and Article V of GATS for the agreements that are notified separately under each. Thus, in total, 62 agreements are registered as notified, with only 11 of them coming under the Enabling Clause. From a cursory inspection of the agreements that are not notified, it appears that they too will ultimately be notified under this category.

As mentioned above, a harmonized taxonomy of trade agreements is yet to be universally applied and, in many cases, the textbook taxonomy of PTAs is not followed in work of policymakers and/or researchers and analysts. Various databases also use different approaches. Table 2 includes types of agreements reflecting titles used to describe the agreements by countries themselves. Two thirds of the effective agreements in the Asian and Pacific region belong to the free trade area (FTA) category. They also include agreements in the area of trade in services, as APTIAD still does not record them separately. There are only two customs unions and 10 preferential trade agreements that are agreements of “partial scope” in WTO classification. A large number of the agreements (18) are classified as framework agreements. In the understanding of the WTO RTA disciplines, these should not be implementable as trade liberalization agreements. Rather, they should serve to guide negotiations on the “proper” type of the agreement. However, in Asia and the Pacific, some of these framework agreements contain an “early harvest programme”. As such, they should be notified as “partial scope agreements”, which is not often the case.<sup>5</sup>

The fast multiplication of agreements shown in figure 1 resulted in an increasing density of the “noodle bowl”<sup>6</sup> phenomenon associated with preferential trade. The “noodle

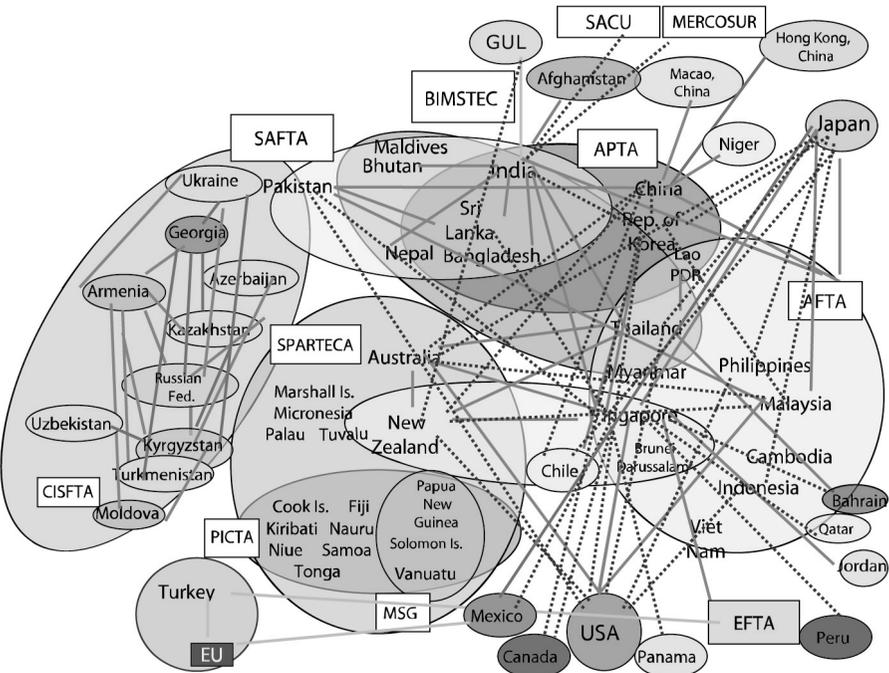
<sup>5</sup> Of these, only the ASEAN-China Framework Agreement, in force since 2003, was notified in 2004.

<sup>6</sup> See Bhagwati, 1992, who is credited with introducing the original term, “spaghetti bowl”. “Noodle” was apparently introduced to the RTA vocabulary by Findlay and Pangestu (2001). Cf. Mikic, 2002.

bowl” of preferential trade refers to the entanglement of bilateral and regional free trade and other types of agreements that are in force as well as those that are in various stages of negotiations (figure 4). It is quite appropriate to describe this state of affairs as a “motley assortment” (Baldwin, 2006) that is working against trade creation rather than for it. With conflicting rules, these preferential agreements tend to fragment markets and increase trade costs, thus adversely affecting trade volumes as well as global and national welfare. For example, figure 4 illustrates how current regionalism results in the fragmented Asia-Pacific market, with no established trade agreements between Central Asia and rest of Asia and the Pacific. Likewise, the Pacific is far from being well integrated into Asian regionalism, while links between South Asia and the rest of the region are just emerging. It appears that only the Asia-Pacific Trade Agreement (APTA) links South Asia, North Asia and Southeast Asia, as well as high- and low-income developing countries. Therefore, in terms of promoting south-south cooperation, this agreement has a desirable scope.

The previous analysis reveals that from 1994 to the present, the number of all agreements in force expanded from 10 to 91, a more-than-eightfold increase. Of the total 58 ESCAP regional members, those involved in this proliferation of agreements increased

**Figure 4. Noodle bowl effect in Asia and the Pacific**



Source: APTIAD, Feb 2007, some PTAs not shown.

from 41 to 50 during the same period.<sup>7</sup> Only one ESCAP-cum-WTO member remains unattached to any of the trading blocs. In contrast, most ESCAP members who are not WTO members are members of at least one and up to 11 PTAs. The average number of agreements in force per ESCAP member, not counting those countries without any agreements, is 5.6. This indicates multiple memberships and a significant overlap in the membership of agreements.

Overlapping memberships arise from parallel BTAs and RTAs for the same set of economies. One country ends up negotiating with another under several unrelated framework agreements. Multiple and overlapping membership is spread across this region. Only eight ESCAP members and associate members are not involved in PTAs. The maximum number of agreements implemented by a country belongs to Singapore (19), followed by Thailand (15), India (13), Malaysia (12) and Turkey (12).

The issue, however, is that with multiple agreements it is not known which particular set of rules drives trade growth or which set might act as an obstacle. The question should also be asked whether an even larger effect on trade could have been achieved with fewer agreements and, arguably, lower costs. Finally, the impact of unilateral liberalization processes in countries that are party to such agreements should not be ignored.

The total trade of ESCAP members has increased in absolute terms, and in 2005 accounted for almost 30 per cent of world exports and imports. The value of their intraregional trade also increased dramatically from 1980 to 2005 in absolute terms. Starting with a slightly smaller value of intraregional trade than the North American Free Trade Agreement (NAFTA) in 1980, by 2005 the intraregional trade of Asian and Pacific region had surpassed NAFTA and had closed the gap with the European Union (15) from four-fifths to one-third. As a share in total world trade, this intraregional trade grew only slightly faster than the share of total Asia-Pacific trade in world trade (coefficient 1.36 compared with 1.29 – rows 1 and 3 in table 3).

This information on growth in intraregional trade can be combined with an indicator of trade dependence to tell us more about the “fortress building” attitude of trade agreements. As table 3 shows, total trade dependence,<sup>8</sup> which is a contribution of total trade to the region’s collective gross domestic product, increased by coefficient 1.5 over this period. As trade can be split into intraregional and extraregional categories, it is helpful to track intraregional and extraregional trade dependence as separate indicators. Thus, an indicator showing only the contribution of extraregional trade to the region’s gross domestic product

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<sup>7</sup> Agreements of non-regional members are not covered in the analysis unless signed with one or more regional members (e.g., the United States–Singapore FTA is included, while the United States–Jordan FTA is not). This currently leaves only three ESCAP members (Mongolia, Palau and Timor-Leste) and five ESCAP associate members (American Samoa, French Polynesia, Guam, New Caledonia and Northern Mariana Islands) not involved in preferential trade. Of those countries, only Mongolia is also a WTO member.

<sup>8</sup> This indicator is often interpreted as “trade openness”. See Bowen, Hollander and Viaene, 1998, pp. 12-15.

**Table 3. ESCAP trade performance basics**

Category	(Unit: %)					
	1996	1998	2000	2002	2004	2005
Total ESCAP trade/world trade	22.7	23.4	26.3	26.3	28.2	29.4
Total intra-ESCAP trade/world trade	10.7	10.3	12.4	12.7	14.0	14.6
Total intra-ESCAP/total ESCAP trade	47.3	44.0	47.2	48.4	49.6	49.8
Total trade dependence	33.1	35.3	39.4	38.8	46.6	50.0
Intra-ESCAP trade dependence	19.0	18.1	20.1	18.8	23.1	24.9
Extra-ESCAP trade dependence	14.1	17.2	19.3	20.0	23.5	25.1
Marginal propensity to trade (total) <sup>a</sup>	...	-0.29	0.68	-0.17	0.71	0.85
Marginal propensity to intra-ESCAP trade <sup>a</sup>	...	-0.08	0.38	-0.25	0.37	0.43
<b>Total number of BTAs in force</b>	<b>17</b>	<b>22</b>	<b>26</b>	<b>30</b>	<b>46</b>	<b>63</b>
<b>Total number of RTAs in force</b>	<b>5</b>	<b>6</b>	<b>6</b>	<b>6</b>	<b>8</b>	<b>11</b>
Members with WTO status	22	24	25	26	29	29 <sup>b</sup>
Members with PTA status	44	44	44	45	49	50

Source: Compiled by the author from APTIAD, WITS and WDI, May 2007.

<sup>a</sup> Marginal propensity to trade = change in trade value/change in GDP value (ranges from 0 to 1).

<sup>b</sup> 31 in 2007 (e.g., Viet Nam and Tonga became members on 11 January 2007 and 27 July 2007, respectively).

grew more than the total trade dependence (coefficient of 1.8 during the same 10 years), while intraregional trade dependence grew by less – coefficient 1.3. Despite relatively small differences in these coefficients, they point to a lack of a significant increase in the reliance on intraregional trade by ESCAP economies, giving no strong support to a claim of the “appearance of the third mega trading bloc” to join the European Union and NAFTA. Thus, even though intraregional trade is growing in both the absolute and relative sense, it is difficult to identify this trend as trade diversion.

Furthermore, a reliable measure of a link between the increase in intraregional trade and the existence of preferential trade (i.e., BTAs and RTAs) is still lacking. In addition, does trade growth among members of the agreements precede or follow preferential agreements? These questions remain high on the list of future empirical research topics.<sup>9</sup> Identification of the share of trade associated with the establishment of the preferential trade area is still one of the most tedious forms of empirical trade research (cf. Mayda and Steinberg, 2007 and DeRosa, 2007).

<sup>9</sup> See Mayda and Steinberg, 2007 on the lack of evidence for across-the-board new trade creation in response to the Common Market for Eastern and Southern Africa, and DeRosa, 2007 for slightly different arguments.

In 2005, slightly less than 30 per cent of total ESCAP trade was associated with members of BTAs and RTAs (table 4) even though intraregional trade amounted to almost 50 per cent of total ESCAP trade with the world (see table 3). This trade among the BTA/RTA members amounted to less than 9 per cent of world trade.<sup>10</sup> While close to 60 per cent of PTA-linked intraregional trade was done by members of BTAs, more than half of that was linked to BTAs that had one extraregional member (e.g., the United States, European Union/EFTA). This could indicate that there is still a great deal of untapped potential for developing intraregional trade linkages among ESCAP members.

**Table 4. Trade of BTAs and RTAs in force, 2005\***

	Share in total ESCAP trade (%)	Share in total world trade (%)
BTAs (61)	<b>16.2</b>	<b>4.7</b>
– Regional (33 BTAs)	6.6	1.9
– Other (28 BTAs)	9.6	2.8
RTAs (11)	<b>13.2</b>	<b>3.9</b>
– Regional (6 RTAs)	10.2	3.0
<b>Total preferential trade</b>	<b>29.4</b>	<b>8.6</b>
<b>Total ESCAP trade</b>		<b>29.2</b>
Memorandum items:		
– Total ESCAP trade (US\$ billion)	5 764	
– Total world trade (US\$ billion)		19 585

Source: Computed using APTIAD and COMTRADE data, May 2007.

\* Where 2005 trade data are unavailable, data from the most recent available year are used.

## B. Architecture

In this section,<sup>11</sup> the architectural characteristics of the Asia-Pacific preferential agreements are assessed. The scheduling approach in terms of tariff liberalization, extent of liberalization, types of trade barriers tackled by agreements, rules of origin and sectoral coverage is examined.

<sup>10</sup> Note that table 1 shows intra-ESCAP trade as 14.6 per cent of world trade in 2005. Intra-ESCAP trade is larger than the sum of trade by members of BTAs and RTAs under implementation (which makes up 8.6 per cent of world trade).

<sup>11</sup> This section borrows heavily from Mikic, 2007.

## 1. Approaches to tariff reductions in PTAs

How important is the contribution of preferential trade liberalization to the opening of a country? As noted above, declarative aspirations of all agreements are to transform trade among partners into duty-free trade. In many agreements, in fact, this is expressed as an ultimate goal; however, partners are taking many different routes to achieve this end. Table 5 summarizes the difference in approaches to tariff reduction in the enforced agreements that provide this information. A positive list approach is considered, in principle, as less liberalizing; it consists of members agreeing to the products on the (positive) list whose tariffs will be reduced or eliminated. A negative list approach assumes the reduction/elimination of tariffs on all products except those that are included in the negative list. This approach is closer to the spirit of GATT, even though it may often include a long list of excluded products.

Another important factor is the determination of a base tariff rate as a benchmark for reduction. In most cases, the MFN-applied rates are used for this purpose (cf. Feridhanusetyawan, 2005). In an effort to comply with WTO rules on regional agreements, most contain an intention to eliminate tariffs within what is considered a reasonable period. When an LDC is involved, it is provided either with longer transition periods (e.g., AFTA) or lesser or no reduction commitments (e.g., APTA). Another interesting feature, and one that supports previous claims about "made-to-measure" agreements, refers to asymmetrical reciprocity in tariff reduction even when there is no LDC involved. Feridhanusetyawan (2005) described how, in the Singapore-United States FTA (which follows the "negative list approach"), the United States kept tariffs on about 8 per cent of products during the transition period of eight years while Singapore eliminated all tariffs immediately, binding them to zero. In the Singapore-Japan FTA (which follows a positive list approach), Singapore again reduced all tariffs to zero immediately while Japan committed to eliminating its tariffs gradually over a 10-year period.

**Table 5. Tariff reduction approaches**

PTAs	Positive list	Negative list
All agreements in force (that provide information)	31	33
Bilateral trade agreements	22	25
Cross-continental plurilateral	0	1
Country-blocs	3	2
Regional trade agreements	5	5
Global	1	0
Free trade agreements	20	29
Framework agreements	4	1
Preferential trading agreements	6	2
Customs unions	0	1
Non-reciprocal arrangements	1	0

Source: Compiled by the author from APTIAD, February 2007.

## 2. Rules of origin

The current proliferation of agreements has spun a complex web of rules of origin (table 6). In addition to each agreement having its own rules of origin, a bewildering array of product-specific rules of origin is emerging. Adopting the less restrictive rules of origin could result in significant trade deflection and redundancy of a trade agreement, while adopting the most restrictive rules of origin may result in no trade taking place under the agreement. Several chances have been missed, at both the WTO and regional levels, to bring some uniformity to the formulation of preferential rules of origin. GATT Article XXIV, quite remarkably, is silent on the use of preferential rules of origin. Should rules of origin not be viewed as just “other regulations of commerce” (referred to in Article XXIV of GATT), in that they should not raise barriers to third countries any higher than the level existing prior to the formation of PTAs? The most that is said is embodied in a non-binding common declaration on principles.

**Table 6. Rules of origin provisions in selected trade agreements**

PTA	Change in tariff class.	Specific man. process	Local value addition	Cumulation
<b>BTAs</b>				
ASEAN-China	Yes	...	40%	Full
ASEAN-Republic of Korea	Yes	...	40%	Full
Australia-New Zealand	...	...	50%	Bilateral
India-Thailand	Yes (or VA) 4, 6 digit level product specific	...	20-40% product specific F.O.B. value	Bilateral
India-Sri Lanka	Yes (or VA) 4 digit level	...	35% F.O.B. value	Bilateral
Japan-Mexico	...	No specific process required	50% with some exception F.O.B. value	Bilateral
Republic of Korea-Chile	...	No specific process required	45% build down method calculation, 30% build up method calculation	Bilateral
Malaysia-Japan	Yes (product specific)	...	40% (product specific)	Bilateral
Singapore-Republic of Korea	Yes	...	45-55%	Bilateral
Singapore-Japan	Yes (or VA) 4 digit level	Yes	60% F.O.B. value	Bilateral
Singapore-USA	Yes (or VA) 2, 4, 6 digit level	Yes	30-60% product specific	Bilateral

Table 6. (continued)

PTA	Change in tariff class.	Specific man. process	Local value addition	Cumulation
Singapore-New Zealand	...	...	40% Factory cost	Bilateral
Singapore-Australia	...	...	30-50% product specific factory cost	Bilateral
Thailand-Australia	Yes (and/or VA) 4, 6 digit level product specific	Yes	40-55% product specific F.O.B. value	Bilateral
Thailand-New Zealand	Yes (product specific)	Yes		Bilateral
<b>RTAs</b>				
Asia-Pacific Trade Agreement	No tariff beading change necessary	No specific process required	45% (35% for LDC)	Full
ASEAN Free Trade Agreement	No tariff beading change necessary	No specific process specified	40% F.O.B. value	Full
Trans-Pacific Strategic Economic Partnership TRANSPACSEP	Yes	Yes	45-55%	Diagonal (bilateral)

Source: Compiled from table 2 in Bonapace and Mikic (2006); and APTIAD.

This increases the urgency for establishing an overarching, region-wide, common framework of principles, guidelines and procedures to which BTAs and RTAs would be anchored. Notwithstanding its non-binding nature, the point of departure should be the WTO common declaration. Ongoing work, notably in APEC, and other useful trade and development elements found in other agreements should be built upon with this need in mind. For example, APTA recently agreed to common rules of origin (representing a wide spectrum of industrial development among the members) that are relatively simple, general and liberal, that is:

- (a) A flat rate of a minimum 45 per cent of local value content (35 per cent for LDCs) in bilateral rules of origin; and
- (b) At least 60 per cent (50 per cent for LDCs) of regional content with full cumulation (cf. Baldwin, 2006).

Section C of this chapter discusses prospects for multilateralization of Asia-Pacific PTAs in terms of geographical consolidation. However, it is possible to approach multilateralization through the functional consolidation in different areas, such as rules of origin. Consolidation of multiple membership agreements around more liberal rules of origin will serve as a tool for diminishing noodle bowl-related costs of trading under preferential regimes. One such example is provided by the recent consolidation of bilateral

trade agreements among the southern European countries and a replacement by the common rules as part of an amended Central European Free Trade Agreement (CEFTA) deal. The new CEFTA consolidates 32 bilateral trade agreements into a single regional trade agreement. The free trade area will be established for a transitional period ending, at the latest, on 31 December 2010. The new consolidated agreement replaces the network (“spaghetti bowl”) of bilateral trade agreements in order to improve conditions for promoting trade and investment by means of fair, clear, stable and predictable rules.

The agreement consolidates and modernizes the region’s “rule book” on trade, and includes modern trade provisions on issues such as competition, government procurement and protection of intellectual property. It facilitates the convergence of relevant trade-related rules, notably with regard to industrial and sanitary-phytosanitary rules. A simplified single system of rules of origin (and other rules) makes it easier to trade within the region. Increased trade is necessary to promote growth, job creation and a reduction in youth unemployment. It is the foundation for stability and peace. Such harmonization and simplification of rules of origin in the subregions of Asia could contribute to a deepening of integration, as the rules are associated with an increase in “seamless production”.

### **3. Going beyond the goods trade<sup>12</sup>**

Many of the newer initiatives declare the intention to go well beyond the reduction/elimination of tariffs and NTBs, including anti-dumping and safeguards, harmonization of competition policies and standards, and customs. However, a large number just remain a collection of aspirations towards liberalization that tend to be associated with a longer negotiation process. In addition, despite these intentions to go deeper than trade integration, there is only an occasional mention of the formation of a CU or a common market in the Asia-Pacific region.<sup>13</sup>

Furthermore, in the context of multilateral liberalization, a number of countries strongly argue for more freedom in movements of labour (referring to Mode 4 liberalization) when it comes to BTAs and RTAs, as only a few cover this area. A comparison of BTAs/RTAs of the Asia-Pacific region with existing deals in the Americas also illustrates a type of reluctance to negotiate all-inclusive comprehensive agreements. Instead, trade agreements are often accompanied by separate agreements on services, investments, intellectual property protection, customs procedures etc. Most of the new agreements cover trade in services. (However, pre-GATS agreements still have separate agreements on trade in services, such as the ASEAN FAS).

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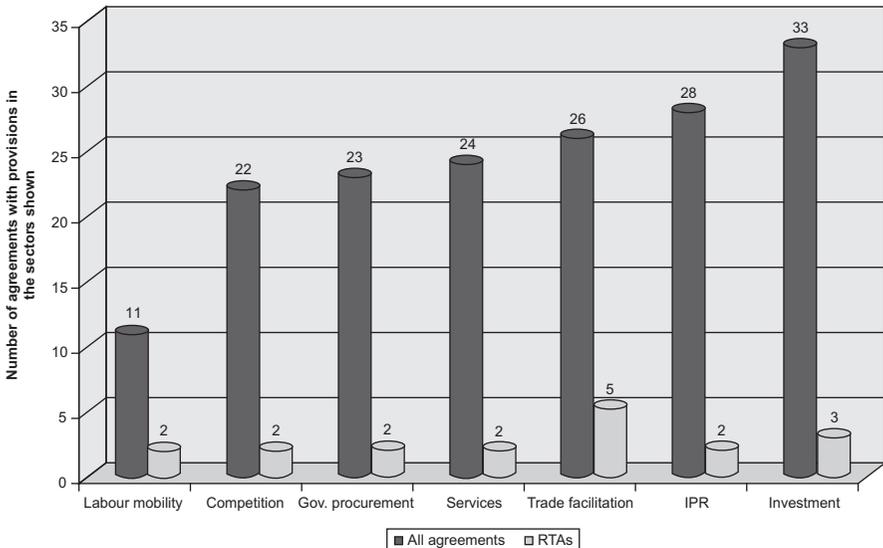
<sup>12</sup> Some of the agreements do not have legal texts either publicly available in English or at all, and therefore might not have been captured properly in counting the sectors covered.

<sup>13</sup> One such example is that of the already cited “single economic market” of Australia and New Zealand. At the zenith of the 1997 Asian economic crisis, there were also calls for the establishment of a currency union. They were later merged into proposals for an East Asian Community.

Most of the newer agreements could be described as WTO-plus agreements as they extend concessionary coverage beyond multilaterally agreed disciplines to areas such as government procurement, competition policy and the environment. This is true for trade agreements between developed economies, and between developed and developing economies (Leshner and Miroudot, 2006). It is important to note that most agreements mention a number of WTO-plus sectors when describing the objectives of the agreement (typically in the preamble of the agreement text). However, a significant number of agreements only include a statement of intention to negotiate liberalization in certain areas. These agreements have been excluded from the scope of this study because they do not count for “substantive commitments”.

The overview that is provided in figure 5 only shows whether a concessionary commitment has been made in a particular sector or not. In order to provide a better assessment of the beyond-the-goods commitments, a more detailed analysis of the legal texts of the agreements is required. The most frequently covered area is that of investment provisions followed by IPRs and trade facilitation. Other areas that also receive some coverage are government procurement, competition policies and labour mobility. Services are only covered in 24 agreements, including separate agreements for some parties. Table 7 provides a summary of treatments of four sectors (investment, IPR, labour mobility and services) with a view to differentiating between BTAs and other agreements in terms of the coverage of these sectors.

**Figure 5. Overview of sectoral coverage by PTAs**



Source: Compiled by the author from APTIAD, February 2007.

**Table 7. Summary of treatments of selected sectors in preferential trade agreements in Asia and the Pacific**

Intellectual property protection						
	Total	Type of agreement				Notified to WTO
		FTA	FA	CU	Other	
BTA	19 <sup>a</sup>	16 (7)				17 (7)
Country-bloc	6 <sup>b</sup>		2	(1)	–	5 (3)
RTA	2	1	–	–	1	2
Other	1	1	–	–	–	–
<b>Total</b>	<b>28 (9)</b>	<b>21 (8)</b>	<b>3</b>	<b>(1)</b>	<b>3</b>	<b>24 (10)</b>
Investment						
	Total	Type of agreement				Notified to WTO
		FTA	FA	CU	Other	
BTA	23 <sup>c</sup>	17 (4)	5	–	1	17 (4)
Country-bloc	6	2	4	–	–	3
RTA	3	2	1	–	–	1
Other	1		1	–	–	–
<b>Total</b>	<b>33<sup>a</sup> (4)</b>	<b>21 (4)</b>	<b>11</b>	<b>–</b>	<b>1</b>	<b>21 (4)</b>
Mobility of labour						
	Total	Type of agreement				Notified to WTO
		FTA	FA	CU	Other	
BTA	8	7	1	–	–	7
Country-bloc	1	–	1	–	–	–
RTA	2	1	1	–	–	–
Other	1	1	–	–	–	–
<b>Total</b>	<b>12</b>	<b>9</b>	<b>3</b>	<b>–</b>	<b>–</b>	<b>7</b>
Services						
	Total	Type of agreement				Notified to WTO
		FTA	FA	CU	Other	
BTA	18	17	1	–	–	14
Country-bloc	3	2	1	–	–	3
RTA	2	–	2	–	–	–
Other	1	1	–	–	–	–
<b>Total</b>	<b>24</b>	<b>20</b>	<b>4</b>	<b>–</b>	<b>–</b>	<b>17</b>

Source: APTIAD; annex tables 2-5 in Mikic, 2007.

Note: Figures in parentheses are the number of agreements involving Turkey.

<sup>a</sup> Includes seven BTAs between Turkey and Bosnia and Herzegovina, Bulgaria, Croatia, Former Yugoslav Republic of Macedonia, Israel, Romania and Tunisia.

<sup>b</sup> Includes one agreement between Turkey and EFTA, and one between Turkey and the European Union.

<sup>c</sup> Includes four BTAs between Turkey and Bulgaria, Former Yugoslav Republic of Macedonia, Romania and Tunisia.

In terms of scope of agreement, it is obvious that the “beyond-the-goods” sectors are captured more often by agreements that are bilateral, i.e., between two countries or between an established bloc and a country. It is mostly FTAs that venture beyond goods liberalization, except in the case of investment where FAs also feature. It also appears that BTAs-FTAs are notified to WTO more quickly than other agreements, thus contributing towards transparency of trading rules at the global level.

### **C. Towards multilateralization: How?**

Arguably, regionalism practiced by countries of Asia and the Pacific does not facilitate trade effectively. There is a need to start managing this process sooner rather than later, but the best approach has not yet been identified (cf. Baldwin, 2006; Zhai, 2006; Bonapace and Mikic, 2007). In principle, multilateralization can be pursued after agreements become closer in similarity and have more commonalities in terms of disciplines adopted and extent of liberalization. First, therefore, some progress needs to be made in terms of “harmonization” of relevant areas in the agreements (e.g., rules of origin) before they can be “multilateralized”.

One approach to consolidation that can serve as a handmaiden to multilateralization is through geographical widening of current agreements or the consolidation of several agreements into one; this would apply to both widening the geographical area and replacing what would be a series of bilateral agreements in one region-wide trade agreement.

Amid uncertainties on the closure of the Doha Round negotiations, and the renewal of a number of stalled talks on bilateral and regional FTAs, a proposal to negotiate the so-called Pan-Asian Free Trade Area (PAFTA) is explored here as one possible vehicle of consolidation (WTO, 2006). This agreement is looking towards bringing together 16 members including Australia, China, India, Japan, New Zealand, the Republic of Korea and members of ASEAN (Brunei Darussalam, Cambodia, Indonesia, the Lao People’s Democratic Republic, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Viet Nam). In terms of collective GDP, PAFTA would become the third largest trading bloc in the world after NAFTA and European Union, based on data for 2004.

Among the three, only PAFTA would include non-WTO members (such as Brunei Darussalam, and the Lao People’s Democratic Republic). All three blocs declare “free trade” as their objective. However, exports and imports of the two existing blocs and the new proposed PAFTA differ (table 8). More than half of the European Union’s trade consists of intraregional trade while NAFTA and PAFTA still rely on extraregional partners for their trade. Similarly, figure 6 shows the value of trade among the three blocs in 2005. It is obvious that PAFTA is the “largest” trader, exporting more than US\$ 500 billion to each of the other blocs, and importing close to that amount from both of them, thus creating a substantial trade surplus in this tripartite trade.

In evaluating the potentials of trade agreements, it is useful to use so-called trade performance indicators. In fact, APTIAD features such indicators for the number of agreements

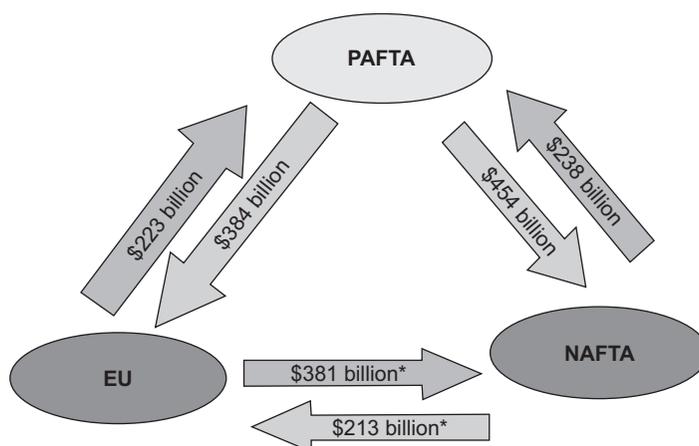
Table 8. Sizing up three hemispheric blocs, 2004

Category	European Union	NAFTA	PAFTA	Memo item: ESCAP
Population	458	429	3 121	3 855
GDP	12 804 020	13 366 295	9 443 842	10 952 556
Total exports	3 598 526	1 315 025	2 108 411	2 478 486
Total imports	3 583 461	1 990 202	1 907 263	2 417 024
Intraregional exports	2 387 270	736 366	801 166	1 146 555
Intraregional imports	2 239 240	702 589	890 276	1 277 805

Sources: Calculated from WDI and WITS, World Bank.

Note: Trade covers merchandise trade; all values are in millions (people or US dollars).

Figure 6. Tripartite merchandise trade



Source: Calculated from WITS data for 2005.

\* EU as a reporting country.

that are already in force in Asia and the Pacific. Indicators can be used ex post to evaluate performance of a free trade or other type of trade agreement after it has been implemented or in some cases ex ante to try to infer economic impact from forming an agreement. Here we use the trade dependence index (TDI) and regional bias index (RBI).<sup>14</sup> These indices are summarized in table 9.

<sup>14</sup> Technical notes on these and other indices and the glossary of terms are available on the APTIAD website at <http://www.unescap.org/tid/aptiad>.

**Table 9. Open – but towards whom?**

Index	Agreement	2000	2001	2002	2003	2004
TDI	PAFTA	20.53	20.43	20.55	22.72	24.61
	European Union	20.75	20.51	19.56	19.15	19.96
	NAFTA	13.96	12.81	12.38	12.77	13.96
RBI	PAFTA	1.89	1.97	1.98	1.90	1.83
	European Union	1.71	1.65	1.61	1.58	1.56
	NAFTA	2.03	2.07	2.10	2.26	2.29

Source: Calculated from COMTRADE data downloaded from WITS.

Note: TDI = trade dependence index; RBI = regional bias index.

The TDI is a standard measure of the ratio of GDP contributed by international trade with the rest of the world. In literature, it is also called the “openness index”. By this measure, it appears that PAFTA is the most trade dependent on extraregional trade (or most open) of the three blocs, since close to 25 per cent of its GDP is generated by trade with others. This overall index, although higher compared to the European Union (just below 20 per cent) and NAFTA (close to 14 per cent) is, however, low compared with those of individual countries of PAFTA, especially small trading economies with extensive re-exporting, where this ratio rises above 100 per cent of GDP.<sup>15</sup> The overall index for PAFTA, being an average, thus obscures significant variations of national indices and underestimates real trade dependence due to the impact of large countries such as Japan, China and India, which contribute more to PAFTA's GDP than to its trade. Notwithstanding this fact, the TDI for the European Union and NAFTA falls over time, signalling more reliance on trade with in region. In the proposed PAFTA area, the opposite trend can be observed – the TDI with the rest of the world increases, indicating relatively less reliance on intraregional trade compared to the other two blocs.<sup>16</sup>

The RBI for member countries in a preferential trade agreement shows a level of bias towards intraregional trade relative to trade with countries outside the agreement area. When the index is equal to 1, the region is neutral in its geographical trade pattern. This means that the share of intraregional trade in its total trade is the same as the region's total trade in world trade. For the three blocs, the RBI values are larger than 1 over the whole period from 2000 to 2004, indicating a bias towards trading with itself.<sup>17</sup>

Because the RBI is calculated without adjusting the values of exports and imports to take into account price effects (such as a rise in oil prices) and exchange rates, care

<sup>15</sup> This is also true for smaller economies in the European Union, such as Belgium or Denmark.

<sup>16</sup> Table 3 provides figures for ESCAP-wide trade dependence (25 per cent in 2005) which follows the same trend as trade dependence for PAFTA.

<sup>17</sup> This index normalizes the intra-regional trade share of a regional trading bloc for group size in world trade as it is expected that a larger group would have a larger share of world and intra-regional trade.

should be taken in the interpretation of these values. As the European Union already has a very high proportion of intraregional trade, it is difficult to envisage further increases in the RBI for that region. NAFTA is similar, but PAFTA should differ as many border and non-border barriers still restrict trade among proposed members. This is despite the existence of bilateral trade agreements among most of the members of the proposed PAFTA (see figure 4). Replacing multiple agreements that are not fully effective in liberalizing trade with one trade liberalizing agreement could help to de-fragment markets and allow faster growth of trade, not the least among developing countries in the bloc. In doing so, progress made by existent preferential agreements in the region should be taken into account in order to combine this geographical consolidation with the functional one. More specifically, simple and regionally cumulative rules of origin as embraced by APTA should be adopted by PAFTA,<sup>18</sup> while full coverage and elimination of tariffs on goods from a number of bilateral agreements in the region should be the goal of PAFTA within a reasonable period (not longer than 10 years).

Regional integration initiatives are often associated with the occurrence of one “domineering” economy (in PTA parlance, a “hub”) that is not only the key player in multiple trade agreements in a region, but also the main driver of regional trade. In this sense, it is useful to compare the country market shares of these three blocs in intraregional exports and imports in 2004. In the European Union, the largest three suppliers to the integrated market are Germany (24 per cent), France (12 per cent) and the United Kingdom (9 per cent). In NAFTA, about 40 per cent of intraregional exports originate from the United States. In PAFTA, Japan contributes 26 per cent of intraregional exports, followed by China (20 per cent) and the Republic of Korea (13 per cent).

At the same time, these countries absorb most of the intraregional imports. In the European Union, Germany, France and the United Kingdom buy 19 per cent, 12 per cent and 12 per cent of total intraregional imports, respectively. The United States is even more dominant as an importer in NAFTA, absorbing 59 per cent of intraregional imports. In PAFTA, China buys 27 per cent, followed by Japan (24 per cent) and the Republic of Korea (12 per cent). Extending supply chains in order to integrate other developing countries, and particularly LDCs, into intraregional exports and imports would be one potential benefit from the establishment of PAFTA.

## **D. Impacts and future research directions**

Are these mushrooming PTAs in Asia and the Pacific a healthy development, or do they make “a noodle bowl” increasingly less palatable? What is their true impact on economies taking part in the process and on the rest of the world? There are different ways in which we can shed some light on these questions. There is, of course, the usual “stumbling vs. building” block type of arguments seeking to assess the impact on the parallel process of multilateral liberalization as well as on multilateralism as an institution (embodied in the form of WTO).

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<sup>18</sup> Cf. Richard Baldwin, 2006.

Although this issue has been heavily researched and debated by many, the gap between the proponents of either view is not any narrower today – 300 PTAs later – than it was when the debate started.<sup>19</sup> Proponents of the “stumbling blocks” view still hold that the proliferation of preferential trade, because of its discriminatory nature, weakens the fundamentals of multilateralism and, indirectly, the case of free trade. They also argue that spreading “negotiating (and political) capital” across multilateral and preferential negotiations leaves developing countries in an inferior position compared to developed countries, thus weakening the former group’s chances for modifying the global system according to their developmental needs.

Advocates of the “building blocs” view, in contrast, put forward positive experiences stemming from the process of PTA proliferation, such as:

- (a) Gaining negotiation experience;
- (b) Obtaining deeper openings in selected sectors/markets, and facing lesser resistance to the opening of domestic markets;
- (c) Allowing firms to learn how to export to friendlier markets;
- (d) Removing divergences in harmonization or mutual recognition areas faster;
- (e) Creating competitive liberalization and thus widening free(r) trade; and
- (f) Providing the possibility of revenue compensation within the preferential bloc.

A relatively new contribution to the “building vs. stumbling blocks” literature (Limao, 2006, among others) indicates that the United States and European Union types of preferential trade have had a negative impact on multilateral liberalization. This impact should be looked at from the perspective of the impact on the governance of global trade (functioning of WTO), and the level of protectionism in global trade. When focusing on the impact made by PTAs in the Asia-Pacific region, it appears that so far they have hindered the operation of WTO in terms of its “rule-making” capacity, even though they have not resulted in any obvious direct trade-diverting costs (Pomfret, 2007).

However, the proliferation of RTAs should be seen as a threat to the business community as well as the global production system, as this regulatory complexity raises the costs of production (for example, see Fung, 2005). It can easily cause production to move from being comparative advantage-based to competitive liberalization-based (cf. World Trade Organization, 2007). This limits the potential of trade to serve as an engine of growth and thus limits the choices of policymakers in the medium to long term.

WTO, which is the main pillar of the multilateral trading system, responded to this RTA proliferation on two fronts. Firstly, it continued to motivate all stakeholders to increase efforts to conclude the DDA successfully (cf. Evenett, this publication). The DDA has pro-development potentials. It can provide market access, which is important to developing country producers. It allows for policy space, which is necessary to the

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<sup>19</sup> See Bhagwati, 1992 for early discussions and Baldwin, 2006 for a summary of more recent debate.

protection of development interests, and not just the narrow interests of a select few. Because it is global, there is scope for delivering trade concessions across more sectors and disciplines than that permitted by many bilateral agreements. Furthermore, it incorporates the use of “Aid for Trade” as an instrument for delivering development through assistance in achieving deeper and wider liberalization of trade, as it can soften trade adjustment shocks. It thus helps trade negotiations to maintain their role of “reform anchors”, as it provides countries with external incentives to implement difficult and costly, yet desirable policy changes that they would otherwise be unable to achieve politically.

Second, WTO members have made progress in their attempt to improve disciplines related to RTAs. A draft decision on a Transparency Mechanism for Regional Trade Agreements awaits conclusion of the DDA to become permanent discipline. Preferential and multilateral liberalization share the objective of liberalizing trade but differ significantly in the approach; RTAs are discriminatory while multilateral liberalization is intended to be non-discriminatory (its principle of non-discrimination or MFN is weakened by various exemptions and exceptions that members permit). This tension between the approaches, among other things, resulted in the move by the WTO members to improve disciplines in the multilateral system on RTAs.

Research in area of trade and investment liberalization and its impact on development need to focus on providing comparative analyses of impacts of alternative path to liberalization from various perspectives (economic, social, developmental and institutional) with direct bearing on policymaking in the region. Objectives of so focused a research programme would include, inter alia:

- (a) The identification of institutional differences in trade policymaking, relevant to engagement in regionalism, and assessment of how differences in the level of “social inclusiveness” between countries influence the choice of liberalization path;
- (b) Estimating direct and indirect costs of engagement in the regionalism path;
- (c) Analyzing the impacts of RTAs in the region and outside it, in terms of trade-creating and trade-diverting effects, and the effects on poverty. It would include various dimensions of impacts (gender, environment, labour standards, democratization and security) in addition to standard economic dimensions of welfare changes (cf. Oxfam, 2007);
- (d) An assessment of how the new “transparency mechanism” adds to the WTO disciplines on RTAs and whether it can improve the quality of RTAs negotiated in the region;
- (e) The identification of possible frameworks and paths for RTA consolidation and the study of possibilities for multilateralization of regional preferences.

It is necessary to stress that both regional and multilateral paths to liberalization will continue to exercise a strong impact on trade and trade policy in the Asia-Pacific region and the world. Notwithstanding the fact that PTAs may be completely “appropriate

solutions to national policy needs, they may confer credibility on policy regimes, [and] help to solve political problems or increase competition” (Schiff and Winters, 2003), there are many other situations where PTAs unnecessarily increase the economic price for non-economic (and uncertain) gains and/or increase cost of an inappropriately chosen trade liberalization path. It is true, therefore, that for many developing countries in the region, the key to development lies in improving overall economic policies, including trade policy. Whether a country follows the regional or multilateral path, domestic economic reform is imperative in order to maximize the gains from trade (and investment) liberalization.

Meantime, both policymakers and researchers have attempted to identify common good policies and practices, and are packaging them in forms of “manuals” or “do/do not” guides (cf. Goode, 2005). Policymakers are advised to consult such manuals with the caveat that good and evidence-based policymaking is definitely helped by tapping into the experience of others while remembering that solid analytical assessment of policy alternatives is required. Furthermore, it is evident that “one size does NOT fit all” and that these collections of good practices and policies can serve only as frameworks for assisting policymakers to identify the appropriate approach for a case at hand.

## **E. Conclusion**

This chapter clarifies what types of preferential trade agreements are emerging in Asia and the Pacific, and it establishes the fact that they vary widely in motivation, form, coverage and content. Bilateral agreements are much preferred to plurilateral or regional ones, while “free” trade areas/agreements are the most frequent form. However, in most cases, they push achievement of “free” trade several years into the future. Increasingly, countries are opting for a partnership or framework agreement – in principle, to signal that either they mean much more than trade integration or that they really do not mean serious trade integration, but are using the format to put together a framework of cooperation in several (non-trade-related) areas. More often, the latter is the case. This probably explains to some degree why a number of countries sign multiple agreements with the same partners.

Analysis has also discovered a reluctance to commit to full and quick liberalization in merchandise trade and to expose “other than goods” trade areas (including WTO-plus) to preferential liberalization. In summary, regionalism in Asia and the Pacific has not, so far, resulted in significant trade-diverting effects for the rest of the world. This also means that it has not succeeded in increasing intraregional trading linkages in terms of enhancing south-south cooperation or region-wide trade. Thus, as one possible approach, the creation of a large trading bloc(s) through policy-led consolidation of binding rules for series of PTAs (currently with heterogeneous rules), without trade-diverting effects for those economies left outside, could be considered.

A necessary next step in research is to establish conceptual frameworks for the consolidation of multiple PTAs, and to determine empirically if and by how much such consolidation of existing preferential deals will improve welfare and reduce poverty compared with the current situation.

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**Comment**

## **REGIONALISM AND MULTILATERALISM: A FORCED MARRIAGE?**

*By Myrna S. Austria*

The proliferation of regional trade agreements (RTAs) and bilateral trade agreements is the most significant trend in international trade policy since the 1990s. Most members of WTO are party to at least one RTA. This is happening even while the world is becoming increasingly integrated because of the intensive trade liberalization around the globe. By its nature, such arrangements discriminate against non-members. Parties to the agreements grant each other preferential treatment on a reciprocal basis. Likewise, as one country can be a member of more than one RTA, the overlapping RTAs can increase the risk of inconsistencies in trading rules among RTAs, which in turn can lead to implementation problems. Such inconsistencies can cause systemic risks on the functioning of WTO by rendering future efforts to develop multilateral rules difficult, if not impossible (Austria, 2003). All these factors have raised concerns over their effects on the trade environment as well as the trading system. Yet, the trend is expected to continue.

### **A. Forces driving bilateralism and regionalism**

Several factors have been seen as contributing to this continuing phenomenon. First, there is now less incentive for countries to engage in WTO, given the extensive tariff liberalization over the past decades. WTO continues to focus on tariffs in manufacturing and less on agricultural products, which is of interest to developing member countries.

Second, tariffs are no longer seen as the most important obstacle to international trade. Non-tariff and non-border issues are increasingly becoming more important in the improvement of international exchange, including trade and investment facilitation, competition policy, government procurement, and intellectual property rights. However, these issues are difficult for WTO to handle because of political sensitivity, since they affect national sovereignty. Nonetheless, many consider these issues easier to negotiate bilaterally or by like-minded countries compared to the diverse WTO membership.

Third, the aftermath of the Asian financial crisis during 1997–1998 has demonstrated the need for cooperation in managing the existing integration. The crisis spread quickly around the region, with little regard to differences in the fundamentals of the economies (Tay, 2001). The kind of integration that already existed in the region was of no help to the economies in doing anything to prevent the contagion (Austria, 2003). This realization increased the awareness of the affected economies that they should do something by themselves as a region.

Fourth, APEC lost its momentum for trade liberalization as manifested by the failure of the Early Voluntary Sectoral Liberalization (EVSL). The disappointing outcome of EVSL shows that moving beyond the voluntary approach for liberalization to binding

commitments may not be relied upon as an instrument for regional liberalization in APEC. The experience also showed that not all members of APEC, particularly Japan and the United States (the two leading economic powers in the world and in Asia and the Pacific), are willing to take active participation in APEC's concerted unilateral approach to liberalization. They are, in fact, more likely to deliver their APEC commitments through the negotiated process of WTO (Scollay and Gilbert, 2001). Hence, formation of sub-RTAs within APEC could be regarded as an instrument for expediting liberalization among "like-minded" economies in the region that are willing to proceed with liberalization ahead of the others.

Finally, in the case of the ASEAN, there is the increasing pressure to stay competitive, including the rapid emergence of China as an economic power and the growing attraction of India among foreign investors. The high level of economic growth of China is disruptive to some sectors in ASEAN, especially in labour-intensive industries. Rising wages and costs in ASEAN are reducing its comparative advantage under the current industrial structure and shifting the balance to China and India (Austria, 2003 and 2005). The presence of global production networks (GPNs) among multinational companies (MNCs) in ASEAN creates an incentive for it to reduce transaction costs through the progressive elimination of rules of origin requirements, reduced trade barriers, and greater capital and labour mobility. Otherwise, an increase in production and administrative costs of these MNCs will force them to move out of the ASEAN region.

However, such an environment for GPNs requires an economic integration that is far deeper and more comprehensive than that currently aimed at by the ASEAN Free Trade Area (AFTA), the ASEAN Framework Agreement on Services (AFAS) and the ASEAN Investment Area (AIA). Thus, given the current resistance to further economic policy reforms in the region, especially from those still recovering from the Asian financial crisis, ASEAN's extraregional linkages provide an opportunity to push the needed reforms that otherwise would have been more difficult, if not impossible, without triggering national and regional sensitivities (Austria, 2006). Most of these reforms are in the areas of deregulation and structural reforms to further promote economic growth (Urata, 2004).

Furthermore, the proliferation of bilateral agreements and RTAs in North America and Europe, and recently in East Asia, has created many new competitors for ASEAN, for both export markets and sources of foreign direct investment (FDI). ASEAN members know that they face discriminatory deals from arrangements in which they are not members. This is particularly relevant to ASEAN-5 who are hosts to a critical mass of global electronics players from the United States, Europe, Japan, the Republic of Korea and Taiwan Province of China (Austria, 2005). Since RTAs/FTAs are characterized by lower barriers to trade and investment, reduced transaction costs, harmonized standards and legal norms, GPNs would prefer to locate their subsidiaries or outsource their production to economies with which their own economies are linked through FTAs (Stein and Daude, 2001).

In addition, the rules of origin in FTAs and RTAs encourage MNCs to locate in economies that belong to the same RTA/FTA as their source economies in order to overcome such rules of origin. In short, RTAs/FTAs in which an economy is not a member may displace that economy's exports. Thus, ASEAN's extraregional linkages provide a way out

from the differential treatment and trade diversion. Effectively, the ASEAN economies are now competing as hosts to GPN-related foreign investment with other developing economies that belong to the same RTAs/FTAs as the economies of the United States, Japan and Europe (Austria, 2005).

Still related to the issue of the proliferation of FTAs/RTAs, ASEAN's extraregional linkages increase its leverage in trade negotiations and discussions, particularly in WTO (Munakata, 2002), and amplifies its voice in regional issues given its increased stakes in regional developments (Soesastro, 2003).

## **B. Making regionalism work**

The proliferation of RTAs has raised concern over the effects on the trade environment as well as on the trading system. The usual question of whether RTAs are building blocks or stumbling blocks for the rules-based multilateral trading system under WTO has been greatly debated in the literature. Whether an RTA brings about a gain in welfare or not depends on the balance between trade diversion and trade creation. Trade diversion occurs when an inefficient company inside an RTA is able to gain market access, because of the preferential agreement, at the expense of an efficient firm in a non-member of that RTA. On the other hand, trade is created when efficient firms within an RTA are able to expand their market shares at the expense of inefficient firms in non-members. The overall impact depends on the net effect of trade creation and trade diversion.

Since regionalism is expected to continue, making it work in favour of global free trade has become a challenge to policymakers, the academia and international development agencies. Possible areas in which this could be attained are:

- (a) Strict enforcement by WTO of Article XXIV of GATT, which allows the formation of RTAs. Article XXIV has not been binding. Thus, all RTAs and bilateral agreements should be subject to (i) a WTO-consistency test, such as the adoption of liberal rules of origin, (ii) ensuring broad product coverage, including sensitive sectors and minimizing exclusions, and (iii) the provision of clear phase-outs of exclusions;
- (b) A frank assessment of RTAs, taking into account their stated motivations and whether those stated motivations are best met by using RTAs; and
- (c) A successful conclusion of the Doha Round, which is still the best solution to possible adverse effects arising from the proliferation of RTAs.

## **C. Possible areas of research**

### **1. Investment issues as they relate to RTAs/FTAs**

Much of the discussion and research concerning the effects of RTAs has been focused more on trade and less on investment. The implications of RTAs with regard to

possible investment diversion should be examined and measured, and particularly the effects on technology transfers and increased productivity and efficiency of domestic firms.

## **2. Reforms at WTO**

The Doha Round should review the relevance and applicability of Article XXIV, given the proliferation of RTAs. WTO should formulate a framework for regionalism to make it work in favour of global trade.

### **3. Common framework for bilateralism/regionalism in ASEAN**

ASEAN is proceeding with an ad hoc approach in dealing with its extraregional linkages, without the guidance of a single common framework. This is also true even among the individual members who are pursuing bilateral trade agreements. The absence of a single common framework makes the building block process more complicated than it appears, if not impossible (Austria, 2006). In fact, it endangers the whole building block process as it could lead to a series of agreements that differ greatly from each other. This could give rise to the “spaghetti bowl” effects, where each agreement will have different scope and tariff reduction schedules, different rules of origin etc. Thus, instead of becoming building blocks, the bilateral initiatives become stumbling blocks.

### **4. Ex-post empirical work on the impact of trade liberalization**

Much of the empirical work on trade liberalization has been ex ante. Usually, computable general equilibrium (CGE) analyses show the positive benefits of trade liberalization. However, some developing countries that have opened up their economies have not experienced the promised benefits of trade liberalization. This has become a question and a puzzle to many. On the other hand, the dynamic effects of trade liberalization on the economy (such as increased productivity, technology transfer, macroeconomic stability etc.) are not captured by standard CGE models. Thus, the effects of trade liberalization could have been understated.

The above issues call for an ex-post evaluation of the impact of trade liberalization. The ex-post evaluation could be a combination of a general equilibrium analysis as well as industrial or sectoral studies. However, the latter has been less studied.

### **5. Impact of non-tariff and non-border issues on growth**

The impact of trade and investment facilitation, competition policy, intellectual property rights, government procurement and other non-border issues on economic growth has received less attention in empirical work. However, since these issues are increasingly becoming the primary factors affecting international exchanges of goods and services, research activities should focus on them.

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