



REGIONAL TRADING ARRANGEMENTS: Stocktake and next steps

*Reflections on a Meeting of the Trade Policy Forum of the Pacific Economic Cooperation Council (PECC), held in co-operation with the Thai Ministry of Commerce
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INTRODUCTION

The meeting of the PECC Trade Policy Forum (TPF) was held to review recent developments in regional economic integration in the Asia Pacific region. The meeting was well attended by approximately 110 participants from 19 APEC economies. There was a strong representation from the Western Hemisphere, with all three institutions supporting the FTAA being represented.¹ The meeting was also well attended by representatives from other international institutions.²

Sessions in the first half of the forum focused on a stock take of the role of RTAs in the Asia Pacific region. This included surveys of broad trends in preferential trading proposals in the region and their implications for APEC and the multilateral trading system, as well as the collation of information on a large number of individual initiatives and on the strategies towards preferential trading arrangements of the major economies in the region. As part of this process presentations were made by officials and researchers from a number of economies involved in preferential trading initiatives. Given that the Asia Pacific region comprises economies from both sides of the Pacific, it was appropriate that information was also presented on developments in regional trade agreements in the Western Hemisphere. This allowed insights to be gained from comparing these developments with developments in East Asia, Australia and New Zealand, and also highlighted the potential implications of parallel developments on either side of the Pacific. As well as providing information on the nature of the new initiatives and the ways that they might develop in future, these

¹ The three institutions are Organization of the Americas (OAS), UN Economic Commission for Latin America & Caribbean (ECLAC) and Inter American Development Bank (IDB).

² Asian Development Bank, OECD and UNCTAD.



sessions also provided valuable insights into the range of motivations that lie behind the new preferential trading initiatives in the region.

The second half of the forum addressed the way forward by identifying the issues faced in designing modern RTAs and the role of APEC and WTO in ensuring consistency of RTAs with open regionalism, the multilateral trading system, and free trade.

This summary aims to present an overview of the main points raised by the presentations made at the meeting and the subsequent discussions that ensued. It represents the personal responses of the authors to the meeting and does not constitute the official views of the PECC Trade Policy Forum or an agreed summary of meeting outcomes. Selected papers from the meeting are also provided as additional material and a full copy of the meeting programme is also appended. The programme and additional papers can also be accessed at www.pecc.net/members_forum/library.htm³.

STOCK TAKE OF REGIONAL ECONOMIC COOPERATION IN ASIA PACIFIC

Main trends and features of recent RTAs

There has been a proliferation of preferential regional trading arrangements elsewhere in the global economy since the early 1990s. In the mid-1990s APEC economies focused on the non-preferential approach to regional trade liberalization embodied in APEC's version of the concept of "open regionalism". From the late 1990s new proposals for preferential trading arrangements began proliferating in the APEC region as well. So far, only one of these proposals has reached the stage of formal agreement. It is quite evident however that several economies in the region are now seriously engaged in the development of new preferential trading relationships, while others are actively considering moves in this direction. Several new initiatives are at various stages of negotiation, while others are under study.

There is considerable diversity among the new initiatives in the region.

In terms of membership, there are a large number of bilateral initiatives – well over twenty at the latest count. Many of these are trans-Pacific, indicating a concern to maintain a trans-Pacific dimension to regional trade integration. Others involve pairs of economies on one or other side of the Pacific. Some bilateral initiatives involve pairs of small and medium sized economies in the region, others involve linkages between a small or medium sized economy and much larger prospective partners, while at least

³ The username and password are "memberpecc" and "pacific1999" respectively. There are 4 sections under PECC members' library : (1) Basic Documents, (2) Standing Committee/ Coordinating Group, (3) Work Plan, and (4) Task Force/ Forum/ Project Group, etc. The papers for the seminar on RTAs have been put under the Trade Policy Forum (Section 4).



one proposal is for a bilateral linkage between two of the region's larger economies. Some APEC economies are already involved in several bilateral initiatives, while others have so far been much less active. Some economies that are now involved in or are considering preferential trading initiatives have previously taken a strong stance against involvement in such initiatives.

In addition to the bilateral initiatives there are also potential initiatives involving much larger groupings of economies. A study has been commissioned on a free trade arrangement among the members of the "ASEAN-plus-three" grouping, and there have also been suggestions for free trade arrangements between ASEAN and individual Northeast Asian economies. The meeting also heard that there is a growing sense that it is appropriate to use the term "East Asian" to describe initiatives involving the "ASEAN plus three" group. Another initiative involving a larger group of economies is the proposal to establish a Closer Economic Partnership between the ASEAN economies and the CER economies of Australia and New Zealand. On the opposite side of the Pacific, all western hemisphere APEC members are involved in the initiative to create a preferential Free Trade Area of the Americas (FTAA) by 2005, and each of them is also separately involved in other regional trading arrangements in the western hemisphere, often involving non-APEC members.

The prospect that large preferential trading blocs may develop on each side of the Pacific raises questions about the future of the trans-Pacific dimension to regional trade integration and also about APEC as a process which has firmly incorporated both the non-preferential approach and a trans-Pacific dimension within its approach to regional trade integration. A strong economic logic can be identified in favour of larger trade blocs on each side of the Pacific. There is also however a strong economic logic supporting both trans-Pacific trade integration and non-discriminatory multilateral liberalization.

There is also great diversity in the content of the proposed initiatives. Features of this diversity include:

- The traditional approach of preferential liberalization of cross-border barriers to trade in goods remains a central feature in many cases.
- Many initiatives go beyond cross-border goods trade issues to include investment, trade in services and trade facilitation issues. In some cases the approach to these issues goes well beyond the provisions of existing WTO agreements.
- The relative weight given to traditional cross-border trade liberalization and trade and investment facilitation measures differs between initiatives. Trade and investment facilitation is heavily emphasized in some proposed initiatives where the parties feel unable to make progress on preferential liberalization of trade in goods, for example because of potential conflicts with WTO obligations.
- The term Closer Economic Partnership (CEP) has been coined to reflect the way that modern RTAs extend beyond the traditional FTA (free trade area) concept. In some cases the term CEP is used to denote initiatives embracing both the traditional liberalization approach and a range of facilitation measures. In other



cases it is used for initiatives which focus only on facilitation and may not include a traditional liberalization component, at least in the first instance.

- There are cases where it has been proposed that sensitive sectors should be excluded, particularly agriculture and related activities such as fisheries. The meeting heard that in some cases this is motivated by a desire to avoid liberalization in the sensitive sectors, while in other cases it was suggested that the issues could be more satisfactorily addressed in the WTO context.
- The meeting heard that in some regional agreements the degree of services trade liberalization in particular is more apparent than real.
- In some initiatives there are also proposals to include provisions dealing with internationally-sensitive issues such as trade and labour and trade and environment.

Underlying driving forces and motivations

These RTAs are also diverse in their motivations, which range through trade, development and political motivations. In brief the main motivations identified, which vary between arrangements and regions, could be grouped under the following categories:

Trade motivation

- Market access: benefits of trade liberalization and better resource allocation. This can be influenced by business interests who want to gain access to existing blocs or who want to create larger regional markets.
- Defensive motivation: even economies that are reluctant to enter into preferential trade arrangements may feel impelled to do so to defend themselves against the consequences of preferential trade arrangements elsewhere. This “domino effect” was evident both among smaller economies concerned at losing ground in competition with their neighbours, and among larger economies concerned with their position in competition with other leaders in the global economy.
- Slow progress in multilateral trade negotiations whilst economies wish to enter into deeper and faster integration at the regional level. Economies adopting this stance claim that RTAs are not inconsistent with the multilateral trading system.
- Impatience on the part of some individual economies with slow progress in existing regional cooperation and arrangements: slow progress towards deeper integration in ASEAN as well as the national economic issues facing some Southeast Asian nations; failure/lack of progress in the APEC EVSL program;
- A perception that current multilateral and regional arrangements are not able to deal with the emerging new issues, especially those related to the knowledge-based economy and to reaching consensus on say, recognition of standards necessary to take advantage of the network industries;
- East Asia’s observations of rapid progress towards regional integration elsewhere, notably the FTAA and an enlarging Europe, compared to slow progress in its own regional arrangements and in the WTO.



Development motivation

RTAs may have a number of important development objectives as well as trade objectives. First, they provide smaller states with enhanced capacity to negotiate and to experience opening up in stages. Second, as has been the case in Latin America, free trade areas have been used to push forward and lock in place unilateral reforms, and as part of an overall strategy of development to open up markets, reduce the role of the state and increase that of the private sector, and to increase competition. Third, recognizing the key role that foreign direct investment can play in economic development, groups such as ASEAN have seen the creation of larger regional markets as an important element in remaining competitive as a destination for foreign investment. Shared development objectives may also be a factor encouraging economies to consider forming bilateral or subregional trade agreements.

Political and Security

Political and security objectives often underlie regional arrangements. Regional agreements may aim at building a sense of community with neighbouring economies, of which economic cooperation is only a part. The notion of regional agreements and cooperation as elements in the approach to broader security concerns is evident in ASEAN, many of the Asia Pacific initiatives and Latin America. If community building is the broader agenda then many bilateral, regional and global associations between economies may pass the “narrow” test of succeeding in their political and security objectives, even if they do not become broad and deep exercises of economic integration. This may apply to APEC as well, which has as one of its objectives to ensure that there is no rift between the two sides of the Pacific. Now with the FTAA on one side and the push for various configurations of East Asian cooperation on the other side, careful thought needs to be given to the role of APEC in promoting trans Pacific cooperation. If the push for APEC-wide free trade or open regionalism is encountering difficulties, a focus for the time being on easier goals such as trade facilitation may allow APEC to continue to serve the function of promoting trans-Pacific cooperation.

In addition to possible underlying political objectives, domestic political pressures in developed economies have also seen the introduction of the more controversial issues such as labor and environment into free trade areas such as NAFTA, the US-Jordan and possibly US-Singapore agreements. The FTAA has taken political objectives one step further by imposing a “democracy requirement” on members, and this has also been done in some individual western hemisphere RTAs, such as Mercosur.

Discussion of motivations

There was much discussion and questioning of these motivations. If the “trade view” of the motivation of RTAs predominates, there may be a greater tendency to conclude that RTAs do not pass broader tests such as net trade creation. The development view on the other hand leads to an assessment in terms of a more mixed range of objectives and outcomes.



There was emphasis on the need to ask fundamental questions about underlying motivations, to probe whether the stated motivations are the true motivations, and to evaluate whether given arrangements are actually meeting their objectives. Even when the stated objectives are held to be appropriate, a follow up question would be whether these motivations are best served by forming RTAs rather than by other initiatives or efforts.

More specifically when considering the role of RTAs for developing economies, if RTAs are intended to promote competition then one should initially observe increased propensity to trade between members, followed over time by a decline in that propensity as ability to compete in the global market increases. Over time one would also expect to see movement along the value added chain. Empirically it was shown that it is not clear that RTAs show evidence of promoting competitiveness in this way (Bora). Furthermore, export competitiveness and development objectives require more than just regional trade liberalization and market access; complementary policies and institutions are also needed. It was also clear that the implications of regional agreements for development may vary depending on whether they are between developed economies, between developed and developing economies or between developing economies. There is also the need to recognize that integration cannot be just focused on regional trade agreements, but that multilateral and unilateral initiatives will have key roles.

As for the objective of RTAs in furthering multilateral negotiations, the issue is whether the proliferation of RTAs should be seen as a push for more progress in the Multilateral Trading System rather than as a way of avoiding entering into new negotiations or of creating alternative structures. Another issue is how effective RTAs have been in pushing and locking in unilateral reforms. There appears to be a mixed record with some evidence of this having worked effectively in some cases in the Western Hemisphere, but also with the observed effect in other cases that in fact unilateral reforms are delayed due to economies holding back on moves to open up until such time as they enter into RTA or WTO negotiations.

It was also pointed out that the analytical literature has tended to reach negative conclusions on the question of whether preferential liberalization facilitates or impedes multilateral liberalisation. Negative conclusions are typically reached by studies investigating whether preferential trade arrangements can facilitate multilateral liberalization that might not previously have been attainable. On the other hand some studies conclude that establishment of preferential trade agreements may inhibit the achievement of multilateral liberalization that might otherwise have been feasible.

It is also not clear whether RTAs do in fact achieve deeper and faster liberalization, or are more successful in dealing with new issues. Compared to the multilateral approach, negotiation of the existing RTAs has been equally plagued by the issue of exclusions of sensitive sectors. Given such observations, it is questionable whether RTAs constitute deeper, faster and broader integration than under multilateral initiatives.



REGIONAL DIFFERENCES IN REGIONAL TRADING ARRANGEMENT DESIGN AND APPROACH

The papers and discussions at the meeting demonstrated some interesting differences in attitudes towards RTAs and regional integration between Latin America and East Asia. The attitude is much more positive in Latin America compared with East Asia, with benefits being seen as outweighing costs. In East Asia the focus of debate and disagreement is still on desirability of RTAs and potential risks, whereas in Latin America the debate is focused more on the strategic issues regarding what type of RTAs to have. That is, issues regarding:

- How broad should the RTA be? Bilateral, RTA, or FTAA?
- How fast should the adjustment period be?
- Which partners should be chosen? What are the criteria for choosing partners?
- What concessions and exclusions should be made?
- What is the institutional support for the RTA? Sub regional organization or what?

In terms of motivation, both economic and political factors are important in both regions. In Latin America the development motivation is typically more important compared with the trade objective. RTAs are seen as the stepping stone towards the greater challenge of opening up multilaterally. They are also seen as a way to enhance market size and thus make trade and investment more attractive. The push toward regional agreements also received new impetus as these economies became more open and undertook market-oriented reforms, and was seen as a way to lock in the unilateral reforms. The political and non-economic motivations in Latin America are multifaceted, including to reduce hostilities among neighbors, to reinforce democracy, and to improve bargaining positions in the Western Hemisphere. The United States and its leadership role has also been a dominant presence in the hemisphere, driving regional activity both directly through its own leadership activity and indirectly through the search of other economies in the hemisphere for an appropriate economic relationship with the United States.

In East Asia, the development motivation is evident with AFTA (ASEAN Free Trade Area), which was seen as providing stepping stones or a “training ground” toward multilateral trade liberalization. AFTA can also be seen as an example of open regionalism because, as commitments under AFTA progressed, the ASEAN economies reduced tariffs unilaterally (Soesastro). Trade motivations are more apparent in the recent proposals. The political motivations of security and forging closer relations with neighbors have also been important factors underlying both the formation of ASEAN and some of the more recent bilateral initiatives in East Asia.

However, the major difference between the two regions is the absence of a proactive leading economy in East Asia. A potential East Asia-level agreement would have Northeast Asia as the core, but that core has yet to take shape as a driving force for economic integration, and if it was to do so it is unclear who the leader would be.



Another major difference is in the approaches to forming RTAs. The FTAA preparations which have been under way since 1994, show a very much more structured and institutionalized approach compared with East Asia and Asia Pacific cooperation. The FTAA has been conceived from the outset as a preferential arrangement. Among its guiding principles it also has clearly defined pillars of democracy, prosperity, eradication of poverty and sustainable development. The approach taken between 1995-8 was both broad and deep, with 12 working groups meeting intensively to prepare for negotiations. The guiding principles have also been laid out clearly.⁴ Technical and analytical support for negotiations are supplied by three institutions, namely the Inter American Development Bank (IDB), Organization of the Americas (OAS) and the UN Economic Commission for Latin America and the Caribbean (ECLAC). By April 2001, draft texts had prepared in readiness for the Third Summit of the Americas in Quebec City. As an exercise in transparency and opening up the drafts to public scrutiny, it was agreed that the draft text should be publicly released. Furthermore, there was an agreement on business facilitation measures, all of which are customs-related.

In contrast the approach in Southeast Asia with AFTA involved a much less structured process, with agreement reached to create AFTA in 1992 without much in-depth study having been carried out. Subsequent development was evolutionary, and proposals for widening and deepening integration, as well as supporting studies, did progressively emerge, but the institutional support provided mainly through the ASEAN Secretariat is not as comprehensive as that provided in the FTAA case. APEC has also very much developed through an evolutionary process with limited institutional support, other than administrative, from the APEC Secretariat. The other regional institutions in East Asia, the Asian Development Bank and UN ESCAP have also not been involved in the same way as the western hemisphere institutions in regional integration preparations, although they have had programs to support multilateral liberalization.

In post-crisis East Asia there was initially a response geared towards regional cooperation on the financial side and more recently there have also been proposals to consider regional cooperation on the trade side. Confronted with the more advanced development of regional cooperation in the other major regions of the international economy, East Asia is in search of an institutional identity that will give it a stronger voice in deliberations on global or wider regional issues. One suggestion has been to establish an OECD-like regional structure to mobilize thinking and policy analysis for important global and regional issues. However, in recognition of resource limitations other less ambitious proposals have also been made.

As already noted, the leading economies of Northeast Asia (China, Japan and Korea) constitute the obvious “core” of any kind of East Asian economic cooperation. However since a coherent approach to economic integration issues has yet to take

⁴ Such as decision by consensus, consistency with WTO, single undertaking, co existence with other bilateral and regional arrangements, and attention to smaller economies.



shape within this “core”, ASEAN has by default become the fulcrum. Thus there are various proposals for an expanded regional economic grouping, such as ASEAN + 3 (ASEAN plus China, Korea and Japan) and ASEAN + 1 (ASEAN plus Japan or China), and AFTA-CER. There is now also a proposal to study Northeast Asian economic cooperation. These proposals are still at the study and proposal stage, and it is not clear whether they will actually lead to RTAs, even if expert opinion comes out in favour of such a development. However, according to speakers at the meeting who are knowledgeable of these processes, those involved in these proposals do recognize the importance of open regionalism.

IMPLICATIONS: UNINTENDED EFFECTS AND RISKS

There was a wide ranging discussion as to whether the trend towards RTAs in the Asia-Pacific region should be a cause for concern. One focus was on how far, and how quickly, the current crop of proposals might be realized as formal regional trading areas or arrangements. On the one hand, some argued that the major driving motivation for the proposals is political and therefore, one need not worry about the regional trading arrangements that might emerge, since these would not be the principal objective and any progress towards more formal and broader economic integration agreements would be slow. Meantime, the initiatives might contribute to the political objective of greater regional stability and security. Any trade arrangements that ultimately emerge might be viewed favourably if they are seen as by-products of the achievement of these political objectives. In any event, most of the recent proposals in East Asia are still at the study or MOU stage, and some appear to be stalled over issues like the inclusion or exclusion of sensitive sectors. It remains unclear as to which if any of the proposals might lead to formal agreements in the near future.

On the other hand, based on some of the presentations at the meeting there could be no doubting the seriousness of the intent with which some economies in the region are pursuing new regional trade arrangements, nor the growing weight of opinion that appears to be developing in favour of some kind of East Asia-wide trade arrangement. Concern was expressed that the haphazard, uncoordinated proliferation of RTAs in the region could become a factor holding the region back from reaching its full economic potential, and could also become a source of increased tensions between economies in the region. If the trend to preferential liberalization is to continue, there are many choices as to how future preferential arrangements are to be configured. One danger noted is that “economic logic” and “political logic” may pull in different directions, and that political pressures may result in developments which reduce potential economic benefits while increasing potential costs and heightening the potential for trade conflict. The design of preferential trade arrangements is also crucial in determining the balance between economic benefits and costs for the region, and indeed for the participants themselves.



In general, whilst there may not have been full consensus on the seriousness of the new proposals and the probability of their reaching successful conclusions, there was clear recognition of the potential adverse effects, risks and unintended effects associated with the proliferation of RTAs. Thus careful study and analysis is warranted, aimed at a better understanding of the implications of RTAs and at identifying ways to minimize their potential adverse effects.

The potential adverse and unintended effects include:

- (i) As is well-known, although RTAs, like other forms of trade liberalization, give rise to trade creation and favourable dynamic effects, they also cause trade diversion. Trade diversion harms the economic interests of both members and non-members alike. Empirically the results on net trade creation compared with trade diversion remain mixed, with some findings of positive net trade creation in Latin America (Salazar), and others arguing that trade diversion has been a serious problem, for example in North America (Panagariya). A key finding is that trade diversion can be minimized if external tariffs are low and the members become more open by further reducing their external tariffs as they enter into an RTA.
- (ii) “Spaghetti bowl” effects can potentially emerge when bilateral and regional agreements proliferate. Each agreement may have different schedules for phasing out tariffs, different rules of origin, exclusions, standards, rules dealing with anti dumping, and other regulations and policies. This will increase the cost of doing business and potentially serve as another source of trade diversion. Even with bilateral arrangements between relatively open economies, there can be multiple rules of origin as demonstrated by the different rules of origin which have emerged under the bilateral New Zealand-Singapore agreement compared with the Australia-New Zealand CER, which turn will potentially be different from those in the Australia-Singapore agreement currently being proposed. The existing agreements in Latin America have also generated this “spaghetti bowl” effect. The increased sophistication of modern RTAs, as they incorporate an expanding range of facilitation provisions as well as traditional preferential liberalization measures, does not provide a defence against the “spaghetti bowl”. “Spaghetti bowl” effects can arise from inconsistent facilitation measures, for instance in relation to standards, as well as from measures dealing with tariffs and rules of origin. In fact the more dimensions there are to the new agreements, the wider is the scope for inconsistencies to emerge not just in the detail of their provisions but even in the principles on which the provisions are based. One presentation used the alternative metaphor of a “bowl of noodles”, and suggested that the outcome of a pattern of RTAs exhibiting inconsistencies at a variety of levels could be likened to the situation where the chef served udon and soba noodles in the same bowl.
- (iii) Deeper integration in regional agreements may be treated in practice as a “backdoor” for certain economies to introduce contentious provisions which have not been and probably will not be acceptable in multilateral agreements,



- such as exclusion of sensitive sectors, rules dealing with labor and environment issues, competition and investment policies.
- (iv) Dangers of the development of unbalanced “hub and spoke” patterns of regional agreements. The balance of advantages in such configurations will tend to favour the “hub” both because of its stronger bargaining position and because of the greater attractiveness to investors of its central location in the pattern of agreements. For similar reasons the way that the agreements deal with the more contentious matters will tend to be tailored to the sensitivities of the “hub”. Once the “spokes” have secured their preferential status, they may resist the admission of new “spokes” to the pattern of agreements.
 - (v) Diversion of attention, resources, and political capital from multilateral and unilateral efforts to regional efforts, especially for small economies. Unilateral liberalization could be postponed until regional and multilateral negotiations are undertaken.
 - (vi) Bargaining power for small economies is best under the WTO system and second best under regional and bilateral arrangements, especially for small LDCs.
 - (vii) Successful RTAs tend to be those between developed economies, less developed economies tend to lose out.

One key question is the impact of RTA membership on prospects for further reduction in an economy’s MFN tariffs, whether through multilateral or unilateral liberalization, and on the attitude to liberalization in the WTO context, for example through a new “round”. As noted earlier, the analytical literature has tended to be pessimistic on the possibility that RTA membership may facilitate multilateral liberalization that might not otherwise occur, and has pointed to the possibility that RTA membership may actually impede MFN liberalization. In practical terms the danger is that businesses may treat as an investment the adjustment to their operations required to exploit preferential market access gained through an RTA. Subsequent multilateral liberalization, which would erode the preferences, may then be seen as threatening that “investment” and may accordingly be resisted. In other words “vested interests” may be created which support the maintenance of preferences and oppose multilateral liberalisation. Businesses may support the expansion of an RTA as long as gains from being able to exploit a larger market outweigh any dilution of their preferred position. If however the point is reached where the costs to business of expanding the RTA begin to outweigh the gains, it can be expected that business would switch to opposition to any further expansion. As a result one path to multilateral liberalization, through progressive expansion and amalgamations of existing RTAs, may be blocked.

One paper expressed disappointment that the region’s new-found enthusiasm for RTAs reflects a dilution of the view that trade liberalization primarily benefits the liberalizing economy (Pangestu and Findlay). Acceptance of this view underpinned the unilateral liberalization earlier undertaken by several East Asian economies, and this has been an important ingredient in the region’s dynamic development. Conversely the diversion of the impulse for liberalization into economically sub-



optimal preferential arrangements may hold the region back from achieving its full economic potential.

In practice the relationship between RTA membership and prospects for unilateral tariff reform seems to be ambivalent. There is some evidence that regional reforms may stimulate unilateral reform in certain cases (e.g. the role of AFTA and the tariff reduction programmes of individual ASEAN economies). There are cases where establishment of RTAs have been followed by unilateral tariff reductions (e.g. the CER agreement between Australia and New Zealand), but examples were also quoted where entry into regional integration arrangements has been followed by an increase in external tariffs (e.g. Mexico, Mercosur) or by a slowing down of unilateral efforts (e.g. Latin America and South Asia) (Panagariya)

Potential for Trade Conflict: Do Larger Blocs Help?

The negative effect of RTAs on non-members can become a source of trade tension. Although proliferating bilateral agreements among smaller economies in the region may have relatively minor economic effects, the negative effects on non-members of trade diversion may nevertheless create widespread irritation among neighbouring economies. The potential for such effects, and for trade tensions to develop as a result, will be greater in the case of bilaterals negotiated by smaller economies with much larger partners. Apprehensions on this count were very much in evidence at the meeting, for example in relation to Singapore's bilateral initiatives and their implications for Singapore's ASEAN partners. The decision of Australia and New Zealand to each "go it alone" in pursuing separate RTA initiatives is also a source of potential future tensions between those two economies. Bilateral agreements between larger economies will tend to have still more significant effects and a correspondingly higher risk of provoking trade conflicts.

Larger more inclusive groupings can reduce the risk of trade conflict by including many of the economies likely to be significantly affected. Empirical analysis shows that they are also likely to deliver larger economic gains to their members. At the same time however the damage to the economic interests of excluded economies is likely to be more severe. Thus an East Asia-wide preferential trade arrangement for example is likely to deliver substantial economic gains to its members but also to have serious repercussions for any western Pacific economies that may be excluded from the arrangement. An East Asia-wide trade bloc would also have significant effects on western hemisphere economies, raising questions about how the potential for trade conflict between blocs on either side of the Pacific might be managed.

It is also important to record that empirical studies continue to show that both successful multilateral liberalization on a global basis and the achievement of APEC's free trade objectives on a non-discriminatory basis offer greater economic benefits to the region as a whole than a preferential arrangement among any subset of APEC members, including an East Asia-wide trade bloc. An APEC-wide preferential



arrangement also promises larger benefits than any more narrowly-based preferential arrangement.

THE WAY AHEAD: NEXT STEPS

Whatever views are held on RTAs, there appeared to be consensus at the meeting that ensuring the progress and effectiveness of the WTO should have top priority. The most effective way to minimize the risks and dangers of preferential agreements is to progressively bring down MFN tariffs. Lower MFN tariffs help to minimize the potential for trade diversion in preferential agreements. By narrowing margins of preference they also help to limit the extent to which business may see itself as having a vested interest in supporting preferential liberalization and opposing multilateral liberalization. A successful new WTO “round” would do much to neutralize the risks and dangers inherent in the proliferation of preferential trade agreements in the region.

The most effective actions the economies of the region could take in the current situation are therefore those which contribute to this outcome. One way to do this would be to forge a regional consensus on the contentious global issues which have become constraints to a new WTO round. These include the issues of labor standards and linkages between trade and environment - issues which have been and will continue to be of importance to the domestic political constituencies of the major developed economies. Since they are unlikely to go away a response to them is needed. At the same time developing economies in the region will clearly want to see a constructive approach taken to the so-called “implementation issues”.

Conversely, failure to launch a new WTO round is likely to send a signal to business that the commitment of governments to multilateral liberalization is not strong. Business may then intensify its support for preferential liberalization, and may increasingly be inclined to insist that preferential liberalization should have priority over multilateral liberalization.

Meanwhile, the proliferation of RTAs is unlikely to subside, and may in fact accelerate, whatever the outcome at the WTO. Therefore, a multi-pronged approach will be needed, including efforts aimed at ensuring that RTAs will be positive for and supportive of the multilateral trading system, and also that they will not slow down unilateral reforms. This implies a need for efforts focused not only on managing the repercussions of the spread of RTAs and minimizing their unintended effects, but also on finding ways to ensure that their implementation genuinely reflects the routinely stated intention of supporting the WTO process. In other words the task is to find ways of harnessing and catalysing RTAs to ensure that they impart further momentum to WTO processes, rather than the reverse.

An important insight from the meeting is the diversity of pressures and incentives involved in the development of preferential trading arrangements. Some of the incentives and pressures will lead in the direction of supporting the multilateral



trading system and a generally favourable economic outcome, while others will lead in the opposite direction. International rules, principles and guidelines can make an important contribution to encouraging the evolution of preferential trading arrangements in which favourable incentives and pressures are maximized and unfavourable ones minimized.

There was agreement that currently available international rules, principles and guidelines, and/or their implementation are insufficient to safeguard against the potential unintended and adverse effects of the uncoordinated proliferation of RTAs.

WTO CONSISTENCY

While the proponents of each RTA typically make solemn statements promising that the arrangement will be “WTO-consistent”, the chief relevant WTO provision, Article XXIV of the GATT, lacks effectiveness because of the well-known lack of consensus as to its interpretation. There are systemic issues of definition, especially with regard to what is meant by “substantially all trade”, “other regulations of commerce”, the implementation period, and the requirement not to raise external barriers. WTO members have not been able to agree on the interpretation of these and other requirements of Article XXIV. Meantime the range of practices found in RTAs among WTO members has steadily increased. This increases the difficulty in reaching agreement on interpretation of Article XXIV, since members will obviously not readily be willing to accept interpretations which would result in their own practices being declared illegitimate. As Ambassador Edsel Custodio put it, in relation to Article XXIV most WTO members are “living in glasshouses” and are accordingly reluctant to begin “throwing stones”. The prospect that consensus will be reached in the near future on the interpretation of Article XXIV is accordingly remote.

Over the years there have been proposals for additional requirements to be included in the test for consistency with the WTO, such as coverage of all (rather than “substantially all”) trade, and standardized approaches to rules of origin and dispute settlement procedures. There have also been proposals to ensure the openness of RTAs by requiring provision for “open accession” and by establishing a commitment to reduce external barriers after an RTA is formed.

Given the lack of consensus on the interpretation of Article XXIV it is not surprising that the WTO’s Committee on Regional Trade Agreements (CRTA) has been unable to satisfactorily perform its task of reviewing each RTA and reaching a conclusion as to its WTO-consistency. Of all the RTAs referred to it, the CRTA has been able to reach a conclusion on the WTO-consistency of only one. It seems unlikely that there will be any significant change in this situation. It is also not clear what would happen if an RTA was in fact found to be WTO-inconsistent.

For now, it seems unlikely that the WTO will be able to clarify contentious issues in the interpretation of Article XXIV or to improve the procedure for assessing WTO-



consistency. It could however mandate greater transparency in the review of RTAs by the Committee on Regional Trading Agreements (CRTA). This could take the form of an RTA review mechanism along the lines of the Trade Policy Review Mechanism (TPRM). The content, impact and issues arising out of each RTA could then at least be made transparent.

ROLE FOR APEC

There was consensus on the scope for APEC to play a role in ensuring “high quality” RTAs since its principles can in fact potentially provide guidelines that are stronger than the WTO-consistency test. The Bogor goal of 2010/2020 implies that APEC economies engaging in RTAs should be committed to multilateralising their RTA commitments by their Bogor target date. The Osaka Action Agenda envisages that this multilateralising of RTA commitments should occur. Existing APEC principles include a requirement for greater transparency and also suggest that RTAs among APEC members should provide for open membership.

A commitment to greater transparency in relation to RTAs would be an important step towards maintaining trust and mutual confidence among APEC members, and would allow for the exertion of “peer pressure” aimed at ensuring that RTAs among APEC members are consistent with WTO and APEC principles and objectives, in practice as well as stated intent. It would also be useful in pointing the way towards adoption of processes within the WTO aimed at increasing the transparency of RTAs, as suggested above. Initial steps towards greater transparency could include detailed statements by each APEC member as to the RTAs to which they currently belong, and an explanation of the substance and content of each of these RTAs. A further step could be the voluntary sharing of information on intentions to enter into new RTAs or bilateral agreements. Another APEC principle with the potential to provide guidance on the design of RTAs among APEC members is the principle of “comprehensiveness”. This principle would suggest that no major sector should be permanently excluded from any RTA between APEC members.

There were also suggestions to develop further APEC principles on RTA design and implementation, and to enhance the credibility of such principles by including concrete targets. For example:

- Explicit commitment by APEC members participating in RTAs that membership in these RTAs will be open to all APEC members by the Bogor target dates of 2010/2020;
- Clarifying the principle of open accession in ways that allow this principle to become more operational;
- Agreement to a standstill, meaning that no new barriers will be introduced even though they may be WTO-consistent;
- Reaffirmation that external barriers of RTA members should continue to be reduced;



- Commitment to adopt simple rules of origin, avoiding any undue complexity, or, as a variant, to adopt the most liberal rules of origin from among any existing arrangements in which the members of a new RTA may be participating; and
- Commitment to broad coverage, with “sensitive” sectors included and exclusions of individual products minimized.

In general any APEC principles on RTAs should emphasise the desirability of ensuring as far as possible that participation in RTAs does not weaken the impetus for domestic reform, and also of ensuring that the design of RTAs takes into account the need to minimize harmful effects on non-members.

The discussions did recognize that APEC principles are non-binding and are based on voluntarism, and thus even stronger principles could be rendered meaningless since there is no mechanism for enforcement. However, APEC can play a crucial role in providing a forum to raise and discuss these concerns without the added pressure of requiring a commitment to formal negotiations. Greater transparency maybe the most realistic target in the near term, but in the medium term the APEC forum could serve the crucial functions both of facilitating the development of understanding among APEC members as to how to design RTAs that do not unnecessarily harm the interests of excluded economies, and also of containing and managing the trade tensions that might otherwise develop as a result of the proliferation of RTAs.

“UNBUNDLING” AND FACILITATION AGREEMENTS

It was pointed out that it may be a mistake to focus too heavily on conventional trade liberalization as applied within the original concept of free trade areas (FTAs) and customs unions (CUs). There are likely to be cases where pairs or groups of economies are interested in developing closer economic relations, including through the reductions of impediments to economic transactions between them, but where for a variety of possible reasons a traditional FTA-type arrangement may have limited appeal. For example, members’ tariffs may have become negligible, except for those in sensitive sectors which one or more of the prospective partners would wish to exclude from the negotiations (e.g agriculture). In turn, if the sensitive sectors are excluded difficulties may be perceived in justifying the arrangement in the WTO context. Nevertheless there may still be considerable scope for further reductions in impediments to economic transactions by addressing non-tariff issues, particular impediments of the “behind-the-border” type. Measures designed to address such issues can loosely be termed trade and investment facilitation measures.

While modern RTAs typically incorporate both traditional FTA-type elements and trade and investment facilitation elements, it is of course possible for economies to enter into agreements dealing only with trade and investment facilitation. Such agreements can be termed Trade and Investment Facilitation Agreements (TIFAs)



rather than Free Trade Areas. Where a conventional FTA-type arrangement is either not possible or not desired for any reason, partner economies may still derive substantial benefits from a TIFA, focusing on non-border impediments to economic transactions between them. The more difficult cross border trade liberalization issues could be left to be addressed in the WTO. It may also be relatively easy to design TIFAs to be open to accession by additional economies. The nature of trade and investment facilitation measures are such that other economies may often be interested in joining TIFAs, while at the same time there may be relatively few inhibitions among the original members against admitting new members.

There may thus be considerable advantages in “unbundling” the different elements typically found in a conventional RTA, so that the different elements can if necessary be developed independently. This would not only allow TIFAs to be developed independently in cases where a traditional FTA-type arrangement would not be viable. Even in a regional initiative which contains both FTA-type and TIFA elements, formally separating the two elements allows the TIFA element to be expanded to take in new members, without raising the issue of whether those new members could or should also accede to the FTA-type element. The “unbundling” of FTA-type and TIFA elements may thus assist in softening the discriminatory effect of RTA developments, turn the spread of RTAs into a more inclusive phenomenon, and create a basis for regional arrangements to evolve organically in ways that contribute meaningfully to the achievement of APEC’s own objectives. TIFAs may thus become catalysts for wider regional integration, particularly if TIFA-type arrangements are likely in the future to be more important than conventional FTA-type arrangements in reducing regional impediments to trade and investment.

Trade and investment facilitation is of course an area where APEC itself has achieved substantial progress (though much more remains to be done). It would obviously be desirable that any developments in these areas within RTAs should be consistent with APEC’s achievements and future work programmes in the same fields. APEC could play a key catalyst role in the development of TIFAs. On issues where consensus has been or can be achieved among its members, APEC could even establish templates or guidelines for such agreements. APEC could seek to establish the principle that any bilateral TIFA among APEC members, or any TIFA element in a more comprehensive regional arrangement, should be made open to accession by other APEC members. APEC-friendly TIFAs can thus promote APEC’s goals of region-wide economic integration at the same time as they reduce impediments to trade and investment between their participants. Where broader-based closer economic partnerships are being negotiated, the inclusion of APEC-friendly TIFA elements could be an important contribution towards ensuring that the closer economic partnership is compatible with APEC’s goals and objectives.



TOWARDS A LARGER EAST ASIAN BLOC?

The empirical studies indicate that the larger the bloc the larger are the likely benefits. A broadly-based East Asian bloc would also eliminate potentially divisive trade-diversionary effects, as noted earlier. It could also eliminate a large part of the “spaghetti bowl” problem, as the FTAA also promises to do in the western hemisphere.

There was much discussion about the scope for larger trade blocs in the region and the feasibility of an East Asian or even APEC-wide free trade arrangement. There were divergent views on this, with many issues being raised in relation to a potential East Asian bloc, from leadership issues to questions of how the cooperation should be developed in practice. In Asia the notion of stepping stones is important and this leads to fundamental questions as to how East Asia ought to organize itself in the global trade arena.

The notion of an East Asian regional trading arrangement was raised, and whilst the initiative is fraught with many difficulties, it did appear, particularly from the contributions of some speakers from Northeast Asia, that the impetus may exist to push the idea further. Some speakers emphasized the historical and political logic as well as the economic logic favouring such a development. If an East Asian regional trading arrangement were to emerge it would of course raise large questions as to the future role of APEC, as a process designed to promote a concept of regional economic integration which includes among other things a trans-Pacific dimension. This trans-Pacific dimension in turn reflects the vital importance of trans-Pacific economic linkages to economies on both sides of the Pacific. However APEC's role develops in future, it seems obvious that it should have a vital part to play in ensuring that new developments in Asia-Pacific trade relations do not undermine the benefits of those trans-Pacific linkages. This of course is in addition to the key role, already emphasized earlier, of working to ensure that regional processes support rather than undermine the multilateral process based around the WTO.

CONCLUDING REMARKS

High Quality Analysis Needed

Whilst there are many recommendations on the next steps ahead, and some consensus on the importance of strengthening the WTO and APEC processes in this regard, there is also the reality that APEC principles are non binding and based on voluntarism, whilst the WTO-consistency test currently falls well short of being a rigorous test in relation to either the content or implementation of RTAs. Given these constraints and recognizing that the trend towards RTAs is likely to continue, there is clearly a need for high quality analysis of the economic effects of potential RTAs to ensure a clear understanding of the issues they raise and their potential impact.