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## REGIONAL TRADE ARRANGEMENTS IN ASIA PACIFIC:

### Where are they taking us?<sup>1</sup>

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## INTRODUCTION

There has been a proliferation of notifications to the WTO of preferential trading arrangements in the 1990s compared with the 1980s. In the last part of the 1990s there were on average 11 notifications a year. Box 1 summarizes the main trends of regional trading arrangements (RTAs) according to WTO (2000a and b) by July 2001.

### Box 1 Summary of Trends of RTAs

- There are an estimated 240 regional trading arrangements (RTAs) out of which 172 (70%) are in force and 68 under negotiations and which are estimated to come into force by 2005.
- Most of the RTAs (90%) are free trade areas (FTAs).
- RTAs comprising of two parties account for around 60% of the RTAs in force and half of those under negotiations.
- Around 30% of RTAs in force or under negotiations (regional and cross regional) involve at least one party being an RTA itself reflecting a growing consolidation of established RTAs.
- 220 regional trading arrangements (RTAs) have been notified to the WTO, with 38 being notified in the 1990-94 period and 80 since the creation of the WTO in 1995.
- The number of notified RTAs in force comes to 119 and was fewer than the total number notified, but is more than double the number in force in 1991.<sup>4</sup>

Source: WTO 2000a and 2000b

Regional trading arrangements (RTAs) here refers to all types of agreements between a small number of countries related to economic policy. Those economies may or may

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<sup>4</sup> Crawford and Laird (2000) report a higher number of 102 notified agreements still in force at "the end of 1998". They break this down to 78 goods agreements notified under Article XXIV, 13 goods agreements notified under the enabling clause and 11 agreements covering trade in services notified under the GATS.



not be close neighbors. Preferential trade agreements (PTAs) are a subset of this broader group whereby two or more economies agree to lower a subset of barriers amongst members. A free trade area (FTA) is an example of a preferential agreement where *all* barriers within the group are removed.<sup>5</sup>

Nearly all WTO (97 percent) members now participate in PTAs and many belong to more than one. Some, like the EU members and Mexico, belong to more than 10 (Crawford and Laird, 2000). In fact EU-centered or related PTAs make up around fifty percent of the notified PTAs which are in force. Free trade areas are the most popular form of PTA. The WTO Secretariat (1998) reviewed 69 agreements in force and of those only 10 were customs unions. Preferential trade also represented an estimated 40 percent of world trade in 1988-92, and 42 percent in 1993-97 (Grether and Olarreaga, 1998) and more recently it has been estimated to be 50 percent (WTO, 2000a and b).

Most APEC member economies are also members of PTAs. Long-standing arrangements in the western Pacific include the ASEAN Free Trade Area (AFTA) and the Australia-New Zealand Closer Economic Relations Agreement (CER). There are a large number of agreements already in place on the other side of the Pacific, including a string of bilaterals<sup>6</sup>, with Chile and Mexico leading the charge. More recently there has been another round of economies entering into PTAs in the region, especially since the APEC Leaders Meeting in Auckland in September 1999.

Findlay (2001) provides further information (and sources) on a sample of these initiatives and the appendix contains a summary of these initiatives. An assessment of these potential arrangements reveals a number of key features. First and foremost is the shift in East Asia towards the preferential route to trade liberalization, especially for economies, which had not entered into any such arrangements in the past such as Korea and Japan. The participation of these economies was a turning point in attitudes to such arrangements in the region. This practice diverges sharply from a previous East Asian consensus on the value of a non-discriminatory approach to reform, a view embodied in the principles of the APEC process, and supported by empirical evidence that such a commitment contributed to growth, development, and greater integration in economic terms and more broadly.

Second the main protagonists in the most recent round of new regionalism in East Asia have been the relatively highly developed economies, such as Australia, New Zealand, Korea, Singapore and Japan. ASEAN economies are already members of their own agreement and have expanded their membership prior to the initiatives by their more developed trading partners. Currently, there is little evidence of activity of other ASEAN members following Singapore's lead and, in fact, a lot of concern regarding the impact of Singapore's shift in strategy on the ASEAN. This trend raises an important question with regard to why the new regionalism appeals to those at later stages of

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<sup>5</sup> In practice of course some barriers are retained such as anti dumping in the case of NAFTA and some sectors are excluded, such as agriculture in the EU.

<sup>6</sup> Details are available at <http://www.sice.oas.org>.



development, and what impact it will have on their trading partners at earlier stages of development?

Third, in line with the trend of the development of RTAs elsewhere, the coverage of these RTAs extends beyond the traditional areas of trade policy (e.g. tariffs and non-tariff measures), and typically includes investment, services and standards. These are areas which the WTO has covered but where the process might be seen to be too slow (e.g. services areas), or where there is only very limited WTO coverage (e.g. investment issues in goods production).

Other notable features of recent developments of PTA are as follows. While some agreements are between close neighbors, others involve trans-Pacific agreements such as between Mexico and Singapore or Korea and Chile. Thus, geographic proximity is not a necessary feature. Only one involves consideration of a combination of two existing regional trading arrangements. There are examples of an individual member of an existing agreement signing with one member of another agreement, such as Singapore and Mexico, or New Zealand and Singapore. Furthermore, the discussions make reference to WTO consistency and also refer to other rules such as open access. The arrangements mooted or under discussion are also all free trade areas, and not customs unions.

It should be noted that most of these recent potential agreements are still in the form of proposals, studies or in various stages of negotiations, and some may never reach agreement, since there remain many unresolved issues, and others may only become implementation agreements associated with APEC processes such as in the area of standards (i.e. mutual recognition) or in the WTO (e.g. services). There may also be separate agreements on investment and on information technology. However, the accelerating interest of RTAs worldwide, and especially within East Asia, a region known to pursue MFN liberalization, should be a source of great concern.

The aim of this paper is to understand the significance of the recent proliferation of PTAs, most of which are bilateral preferential agreements and which are mostly FTAs. We identify the critical risks that are created by the pursuit of these sorts of deals. We identify what we think is a significant, and also dangerous, shift in the culture of policymaking, at least in some economies our in region. The remainder of the paper addresses three sets of questions. First what are the factors driving this interest in a preferential approach to reform? Many of these initiatives are bilateral, and driven by national decision making in an interactive but uncoordinated manner. Second, what are the dynamics of the interaction that is taking place and what outcomes at the system wide level might be observed? Third, if those outcomes are undesirable, what guidance or direction can be applied to the process in the interests of all participants? If some guidance is desirable, are the appropriate institutional arrangements available to provide a mechanism for implementing the cooperation required?

## **DRIVERS OF PREFERENTIAL AGREEMENTS**

A combination of business interests and “policy entrepreneurship” are the origin of the interest in PTAs. There are also some important interactions with the change in the perception of costs of delivering trade policy change through other channels; especially large-scale multilateral processes based on most favoured nation (MFN) principles. This ‘cocktail’ of factors has come together to release a burst of PTA activity in the field in East Asia.

### **Business interests**

Business motivations are a mixture of aggressive and defensive interests. The aggressive interests relate to capturing a share of profits available in protected foreign markets. Business interests recognize that doing so means providing access to their own market. But compared to free trade, business expects a greater gain. When business interests carry a heavy weight in policy making, the outcome is the demand for preferential arrangements (Andriamananjara, 1999).

There is also a reactive component. Businesses see other economies taking these sorts initiatives. One reaction might be to seek to join. If they ask to be let in early they may be lucky. If not and they are rejected, they may a force to create another set of arrangements.

The literature on business interests in a preferential approach to reform also stresses the impact of sunk costs on business thinking and strategy. McLaren (1999), for example, focuses on the effects of a combination of circumstances that contribute to an increase in the demand for trade blocs. Investors, in the environment, which he considers, make investments which are specific to one sector and which are sunk. Their investment choices are based on expectations about future trade policy. If all investors expect free trade to emerge on a global basis, they will invest in areas where they have a comparative advantage. If instead they expect trade blocs to emerge, they will invest in a different way. Firms within the bloc will invest more in the sectors supplied by goods exported by non-members. Firms within the bloc will also become more specialized relative to each other. The presence of these investments, which cannot be reversed, means that the actual gains from multilateral liberalization are less than those from a preferential agreement.

If in addition, there are “negotiating frictions” which make the multilateral liberalization process more costly, then multilateralism might not be worth the effort. The expectation of its failure creates a new set of investments and a new set of sensitive sectors. The expectation of a preferential outcome then comes true. McLaren (1999) summarizes this effect as “a kind of ‘Say’s law’ for regionalism: because of the kinds of investment it generates, the anticipated supply of regionalism may induce its own demand.” The source of the change is that governments are perceived by investors to be not really committed to multilateralism.



Freund (2000a) also stresses the impact of sunk costs in an environment where free trade is expected eventually but where economies have an option of adopting a preferential agreement as an interim step. She shows the initiators are even better off both in the regional agreement period and once free trade is achieved, since they gain due to first mover advantages, in the presence of sunk costs. But the excluded economy (in a three-country world) is worse off in both periods. World welfare is higher in the second period when free trade is realized, but lower in the presence of the regional arrangement in the first period. This analysis fixes the policy sequence of regional arrangements as an interim step prior to reaching free trade. However, the issue is whether the regional step is really an interim one or the final one: free trade may not be realized once the regional step is taken.

Business might also be interested in dealing with new issues and their perception may be that the multilateral processes will not move fast enough to reach consensus on those issues. However, once again, the question is why a preferential approach is superior. Gandal and Shy (2001) consider the incentives for a preferential approach to the recognition of standards. If the home government does not recognize a foreign standard, suppliers of products of that standard incur a “conversion cost” to meet the home standard. Gandal and Shy (2001) show, in a model with one industry, three economies and three varieties of standards, that if governments have to choose between recognizing all standards or none or them, they will recognize all of them (total surplus is higher under recognition). The outcome is then universal mutual recognition of standards.

Gandal and Shy (2001) then consider the option of a standards union and they find that two economies will prefer to establish a union of just two economies when the conversion costs are moderate or very large. The home firms gain from profits on sales in the other member economy and this effect dominates the loss of consumer surplus in the home market.<sup>7</sup> The profit effect of the union increases with the size of the other member so the implication is that a union of the two largest economies generates the greater surplus. There is a strong incentive, in other words, for larger economies to consider the option of a union.<sup>8</sup>

### **Policy entrepreneurs**

Business may demand a shift in policy making with respect to trade policy. But what is driving the supply side of the policy making process?

Some of the arguments used by those who supply policy change, to whom we refer here as policy entrepreneurs, can be summarized as follows. One argument is that a preferential arrangement is seen to be a bold move, and one which contributes to

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<sup>7</sup> Gandal and Shy (2001) find that the excluded country maximizes surplus by continuing to recognize all brands.

<sup>8</sup> There might also be network effects associated with products to which standards are applied. When direct network effects exist, the value of the product increases with the number of consumers who use a compatible product. Gandal and Shy (2001) also show that when these effects are significant, the incentive to form a standards union disappears.



important foreign policy objectives, including greater and more evident status with trading partners, at the same time as responding to the demand for market access from business.

Developing countries have also used the argument of capacity building for the preferential route compared with the multilateral process. For instance ASEAN economic cooperation was often seen as a “training ground” for competition in the wider global market and to enhance the capacity and experience of policy makers.

Yet another type of argument is to use the preferential trading arrangement as a “threat” to others or as an “insurance policy” in situations when the multilateral process is experiencing little progress or even in danger of stalling. The US for instance, the stalwart for free trade under an MFN multilateral framework, began to work on the North American Agreement at the beginning of the Uruguay Round. The current burst of PTA activity also, rightly or wrongly, seems to carry the same sense in the uncertain trade environment created after the failure at Seattle, after the Asian financial crisis, and in the context of what appears to be slow progress in APEC.

The “reported” justifications offered by the various East Asian economies that have entered into new PTAs are worth noting. The idea launched at the last ASEAN summit of an ASEAN+3 agreement was firstly justified as offsetting the potential that East Asia will be left behind economically unless a PTA can be established in the region, given the creation of PTAs elsewhere such as in North America, Latin America and Europe. Second, Goh Chok Tong was also reported, as saying that another concern was the widening gap between North East and South East Asia (Financial Times, November 24, 2000). Singaporean officials have also indicated a shift in their strategy towards a preferential route. Senior Minister Lee Kuan Yew stated that Singapore had to revisit its growth strategy by leapfrogging the region and reaching out to developed countries (Business Times, December 8, 2000), whilst waiting for the recovery process in the rest of Southeast Asia to stabilize. Japanese and Singapore officials have also used an argument about technology, saying that the change in the business environment is too rapid for the WTO to keep pace.

Scollay (per. com.) has pointed out that agreements between East Asian economies and Canada or Mexico can be assumed to be motivated in part by improved access to the US market, and it is not clear what the US response would be. As for the P-5 proposal it is motivated by strategic considerations, but it is not clear how other APEC members would respond. He also points out that some of these proposals are driven by political considerations, and even if there were economic reasons, he asks whether will they really open up the sensitive sectors (e.g. agriculture for Japan and Korea) or whether the tactic is actually an effort to avoid liberalization in the sensitive sectors.

Policy entrepreneurs may also be driven by pressures to achieve reform at home or to lock in reforms at home. A bilateral arrangement is not likely to have sufficient scale and scope to generate benefits to mobilize the political pressure from those in favor of reform. But policy entrepreneurs offer a number of responses to this challenge.





One is that the protected sector at home that is the target of reform is actually the focus of the market access negotiations in the preferential route. The interests in that sector are being offered access to foreign markets in return for greater competition at home. In an oligopolistic setting, as outlined above, business may perceive a net benefit compared to other routes to reform. That is, the analytical work indicates that up to a point the preferential route is a “good deal” (i.e. for an oligopolistic firm, which operates in segmented markets, like many services providers do). The consequence is that participation in such an arrangement induces, or at least appears to induce, further reform at home. Our concern is that this approach will not lead to a sustained program of long run reform and it may become, for reasons we spell out below, just a step towards more complex strategies for sharing rents in protected markets.

Another response to criticism of the preferential route to policy change is that larger scale multilateral processes are too slow. The failure of the WTO ministerial in Seattle to launch a new round of negotiations has prompted a reconsideration of regional approaches.<sup>9</sup> This situation would be expected to reinforce the McLaren (1999) conditions discussed above.<sup>10</sup>

A further argument is that even if the multilateral system is working, experience has shown that it is hard to identify direct benefits to particular export sectors from that system so as to get support for domestic reforms. A more targeted approach of realizing market access is proposed instead, such as that via the preferential route. Although the impact of a preferential agreement is smaller, it is more easily identified. It therefore, according to these views, generates more domestic support for reform.

Both business interests and policy makers will have an eye on the sequencing of the negotiation of agreements. The impact of the new regionalism will not be being measured in terms of each agreement, but in terms of the program as a whole. For example, business will support the reform required under one agreement (e.g. Japan and Singapore) in order to maintain the momentum of negotiations and the use of bilateral agreements, in order to get to larger gains in later agreements (e.g. Japan and Mexico). Those larger gains may require even greater domestic change, in turn requiring further countervailing pressure from business.

Policy makers might also be considering the sequencing of their options. For example, the real target of a preferential approach might be to offset preferential access that a competitor has arranged with a key trading partner; e.g. European access to Mexico compared to that of Japan. If the country discriminated against, Japan for example, is not familiar with the preferential approach to reform, a low cost and low risk initiative might be taken first (e.g. Japan and Singapore), in order to establish some principles which can then be transferred to the more important preferential access to the market

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<sup>9</sup> In some models, the success of multilateralism adds to the demand for a preferential approach. Freund (2000b) shows that low tariffs that result from multilateral rounds can create incentives to pursue preferential reform.

<sup>10</sup> A related consideration, following the experience of the financial crisis, is the proposals for new currency arrangements in the region, as well as those for an Asian Monetary Fund. Noland (2000) provides more discussion of Japan's interest in these strategies.



of the key trading partner (Japan and Mexico). The latter might be driven by business pressure, but the response in the policy making process might be to attack the problem from another starting point. The starting point agreement is low benefit, but it is low cost and, apparently, low risk. The consequence, however, is to add to the proliferation of agreements, and we discuss further below the outcome of the interaction of such uncoordinated policy responses.

Overall, a tight tit-for-tat perspective on trade policy reform has never delivered the large-scale liberalization that has been the foundation of the economic performance of the East Asian economies. The process of unilateral liberalization, as was undertaken amongst others by China, Indonesia, and the Philippines, reflect the perspective that the biggest gains from reform lie in the effects in the home economy. A theme of this paper is that the dilution of this view, as a consequence of initiatives by some economies that have gained the most from it during the course of their development, has damaged the prospects for growth of the region as a whole. It has also diverted attention from, and undermined the commitment to the WTO processes, which further damages the growth of the smaller players in the region.

### **Empirical assessments**

One of the risks of the preferential route is of course the cost of trade diversion and for some arrangements these costs are estimated to be high. Yeats (1998), for example, found such evidence for Mercosur where a contributing factor seems to have been the high margins of preference. However, for some pairings, the cost in terms of trade diversion may be relatively small, when trade barriers are already low. The PTA route then looks like a low risk option.

Apart from low inter-bloc tariffs another parameter which suggests that the risks of a preferential route might be low are high levels of existing bilateral trade (Krueger, 1995). Growth and development in East Asia have led to stronger trade growth and the partners are becoming more important in each other's trade. The consequence is that they look to further options to extend the relationship. The growth in intra-regional trade has not been driven by preferential agreements, but on the contrary occurs as a consequence of trade and growth associated with MFN liberalization. Drysdale (2000) observes that this change has encouraged some in Japan and in other economies in the region, to re-think the value of preferential arrangements.

Policy makers perhaps have also been affected by the literature on the assessment of preferential arrangements. Their interpretation may be that this work supports the preferential approach, in terms of the scale of trade creation compared to diversion, and with regard to the more recent work on the dynamic benefits of reform, even by the preferential route. There is however debate on the value of the empirical work in this field.

A number of factors can affect the propensity of economies to trade with others in their region, including those in formal preferential agreements. One approach to sorting out



these effects is to use a regression model to separate the contribution of natural factors such as complementarity and distance as well as size from membership of preferential agreement (Greenaway(2000), Soloaga and Winters (1999)). An extension of this approach is to test for changes in the effect of membership of preferential agreements over time, and to include dummy variables to test for special effects between members and non-members. Soloaga and Winters (1999) in a comprehensive study of 9 arrangements over 17 years find no indication that the rise in regionalism in the nineties had boosted intra-bloc trade significantly. At the same time, with respect to trade diversion, they found significant effects only for the EU and EFTA.

Computable general equilibrium models have the advantage of providing more options for good choices of base scenarios and for capturing more of the detail of the preferential policies. The models are becoming increasingly sophisticated and able to incorporate scale effects and imperfect competition, and also capital accumulation. The conclusion of the review of work in this field by Srinivasan, Whalley and Wooton (1993) is that the welfare effects of preferential agreements have probably been positive but not necessarily very large. They suggest vigorous proponents of arguments either in favor or in opposition to preferential agreements are probably overstating the quantitative assessments in support of their case (Srinivasan et al (1993:74)).<sup>11</sup>

Krueger (1999) reports larger numbers from more recent studies that are based on models whose specifications permit the identification of more dynamic gains. An example of this approach is the work by Davis, McKibbin and Stoeckel (2000) who simulate the effects of a free trade area involving AFTA and CER, using the APG-cubed model (18 countries and 6 sectors). They allow for allocative efficiency effects, terms of trade changes and capital accumulation for goods and for services as well as endogenous productivity effects. They find positive effects of a joint AFTA-CER FTA (of an extra \$US25.6b GDP in net present value terms in AFTA and \$US22.5b for CER<sup>12</sup>). These gains are nearly three times as great compared to results of an earlier study which excluded services liberalization and which excluded the productivity effect.

An important result stressed by Davis, McKibbin and Stoeckel (2000) is that if APEC proceeds on schedule then the additional gains from negotiation of the AFTA-CER arrangement is relatively small. The gain to AFTA members of an FTA with CER falls to just over \$US10b and those to CER members fall to just under \$US2b. The reasons, as they point out, are that the AFTA-CER trade is relatively small compared to their members' trade with APEC as a whole, and because APEC is not preferential.

The authors identify a number of implications of these results. One they stress is that some of the APEC gains could in fact be attributable to the AFTA-CER connection, to the extent that it encouraged further liberalization in the larger group (Davis et al

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<sup>11</sup> Panagariya (2000) identifies a number of problems in the modelling approaches. Appendix C of "The Angkor Agenda" (available from [http://www.aseansec.org/aem/angkor\\_agenda.pdf](http://www.aseansec.org/aem/angkor_agenda.pdf)) also lists a number of empirical papers.

<sup>12</sup> The real consumption gain allowing for the ability to shift spending through time is 1% by 2005 for AFTA as a whole and 0.6% for CER.



(2000: 40). Again, whether this is the case depends on the outcome of the dynamics of interaction, which is dealt with in the next section.

## **Review**

In summary, we see that a number of key parameters have changed and contributed to a shift in the calculus of the benefits and costs of the preferential route to reform from the perspectives of both the demanders and suppliers of policy change.

A key factor is the interest of business in preferential access to foreign markets. This interest is likely to be more forceful in imperfectly competitive markets, including those where some form of establishment is required. There are significant benefits from being the first movers in those environments. The greater tradability of many services and the growth of foreign direct investment have contributed to this focus in policy making.

Other factors include the move to lower average tariffs in many economies, especially the more developed in the region, the growth in importance of other impediments to trade (standards for example) and the higher concentration of trade among regional partners, especially in East Asia. These changes have affected the assessment of the costs and benefits of entering into preferential agreements. The desire to pursue other objectives through the application of trade policy may also have contributed to the shift in attitudes to preferential reform, which we have observed. Furthermore, the perception of a slow pace, or the expectations of poor prospects, in the major alternative multilateral and regional institutions has led both sides of the policy making market place to look at the other options.

In some economies, the changing environment has tilted the balance so that previously long-held policy positions have been undermined. A spur to policy change might also be a specific set of political issues or events at some point in time. However those shocks to policy makers would not have had induced significant policy change in the absence of the shift in the key parameters just outlined. These events, particularly in some of the more developed economies, have unleashed in East Asia a series of uncoordinated initiatives by a string of economies. The question of where will this lead is the topic of our next section.

## **Where will it lead?**

The question of whether the proliferation of PTAs are stumbling blocks or building blocks to a more open multilateral system has been raised often. There are some circumstances, where according to the recent analytical literature, the uncoordinated program of preferentialism could lead to global free trade. While these results are derived from special conditions (in which just one (differentiated) good (or service) is traded in oligopolistic markets), the circumstances under which the use of preferential reform is likely to lead to free trade are interesting and the results provide some guidance and focus for cooperation.

**Free trade or a bloc-ed up world?**

First consider the case when economies form a bloc (driven by producer interest in getting access to rents in foreign markets) to which others seek membership. If the bloc's constitution says that everyone who wants to join must be let in on the same terms as the original members, then in this environment, excluded members continue to seek to join until everyone is a member.

Another possibility is the merging of blocs. Andriamananjara (1999) also considers the incentives to merge smaller blocs. He starts with a situation in which each economy forms a bloc with one neighbor. In the next stage, the members of one agreement merge with those of one other agreement, and so on. Could this process continue until free trade is reached, or are there circumstances in which it will stop before then? Andriamananjara (1999) finds that free trade is possible but only if the general level of inter-bloc tariffs is low enough (when tariffs are low, the oligopolistic firms who populate this model can make greater profits with unrestricted access to all markets).

These two situations highlight the value of some rules, which apply to the use of preferential agreements, in particular, rules on accession. Such a rule places a discipline on preferential arrangements, especially the manner in which it constrains the dynamics to work in a particular direction. As we noted above, when this rule is absent the bloc stops growing short of universal free trade. That is, when bloc members are given discretion over who can join, they will stop letting in others before global free trade is reached.

Another factor that could drive the outcome further towards free trade is network effects. For example, there might also be network effects associated with products to which standards are applied. When direct network effects exist, the value of the product increases with the number of consumers who use a compatible product. Gandal and Shy (2001) also show that when these effects are significant, the incentive to form a standards union disappears.

In her paper on serial bilateralism, Freund (2000b) provides another perspective on the process of consolidation by examining serial bilateralism. She uses the same segmented oligopolistic market model as Andriamananjara (1999), but now governments maximize welfare, that is, the sum of producer and consumer surplus, plus tariff revenue. The outcome of unilateral policymaking is that each government sets the optimal tariffs on imports from other economies, taking their tariffs as given. In this setting, when bilateral agreements are possible, each country will want to sign an agreement with every other country. The benefits of a bilateral agreement include higher profits from preferential access to foreign markets, and higher consumer surplus at home. These gains always outweigh the loss of profits in the home market and the loss of tariff revenue from offering access to foreign suppliers at preferential rates. This is the case whatever agreements are already in place and whatever other economies have done. The consequence is that the best strategy for each economy is to

have a bilateral agreement with every other economy. In this model, in the presence of uncoordinated bilateralism, the outcome is free trade.

This result is derived in a model with only one good, that is, a partial equilibrium model. Each country treats others in the same way and all the agreements are the same, that is, a move to a zero tariff on imports from the partner. As Freund (2000b) points out, there are costs associated with having a series of bilateral agreements, such as the risks of complex rules of origin. The issue of sensitive sectors is also ignored. The general point (stressed by Findlay (2001) and before him Snape (1996b)) is that the more dimensions there are to an agreement, the more scope there is to apply discrimination in a variety of ways and the more difficult it will be to bolt together the agreements that emerge.<sup>13</sup> The range of issues now being considered, for example, services, standards, investment, add to the dimensions of the agreements. The outcome could be a bowl of noodles made up of not just the criss-crossing of agreements, but also agreements of different coverage, which apply different principles to resolving the new issues. The outcome is actually more complex than a bowl of noodles, since it is an extraordinary concoction of weights and styles, as if the chef had served udon and soba in the one bowl.

The multi-dimensional nature of the agreements is also the source of problems if the consequence of the interaction is a series of star patterns of agreements, that is, sets of hubs and spokes.

### **Hubs and spokes**

Suppose there are three countries, A, B and C. Country A concludes separate agreements with B and C, but B and C do not have an agreement with each other. Country A is the hub and B and C are the spokes. Lloyd (1996), using this example, points out that the hub country A itself could be a regional trading agreement. He also notes that the hub and spoke approach is 'more common than is generally realized' and at that time he pointed to examples associated with the EU and EFTA.

The consistent role of some key economies in the discussions in progress, and the use of bilateral structures, highlight the relevance of the hub and spoke outcome. There is substantial earlier work on hub and spoke arrangements (e.g. Snape (1996a), Wonnacott (1996), Snape, Adams and Morgan (1993) and Anderson and Snape (1994)). The key points they raised can be summarized as follows.

Hub and spoke agreements do not provide equal access to all participants. Even if tariffs were removed along each spoke, the spoke countries would still not have free access to each other's markets. They only have access to the hub. In fact, as explained below, the extent of access is also likely to vary along each spoke. The differential treatment of spoke members can also be a source friction among the participants.

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<sup>13</sup> Another risk is that cooperation could impede the signing of new bilateral agreements and stop the process before free trade is reached.

Snape (1996a) explains how there is an incentive to create tailor made agreements to deal with products which are regarded as ‘difficult’ from the point of the hub country. He also notes how small countries have incentives to join, especially as more and more countries sign up with the hub economy. The hub and spoke system can “spread like a rash”, a process stressed by Baldwin (1997:61) for membership of preferential agreements. The spoke economies may or may not have deals with each other.<sup>14</sup>

Wonnacott (1996) stresses the benefits to the hub economy. It gains benefit from the preference it gets in access to each spoke economy, compared to all the other spokes. Also only firms based at the hub can get duty free inputs from each spoke.

Other ways in which the hub country could gain is that it could divert investment from each of the spokes. This is because of the favored position of that economy, which makes it sensible to build a plant there to get access to not just the hub but also all the spoke economies. Furthermore, a firm based in the hub is likely to be able to get more inputs at low or zero tariffs than if based in one of the spokes – it can source from the hub and any of the spokes. Wonnacott (1996) explains how the result might be an inefficient pattern of investment that remains due to inertia even if the hub and spoke system were to evolve into an FTA.

Spokes lose since they do not gain from free trade with other spokes, they could be damaged by discrimination in other spoke markets and they might have a reduced ability to compete in all markets against firms based in the hub (Wonnacott, 1996).

There are three options for the spokes to respond to such an outcome:

1. More of the same: a spoke could organize equivalent agreements with the other spoke countries. The problem is that the cost of doing so may be high, and the risk is that a series of such agreements negotiated one after the other could simply add to the layers of discrimination, as each pair dealt with their own sets of difficult issues.
2. Make one bloc: all the spokes could consider joining one bloc. However, the original membership of the set of spokes was the result of the pressures from interest groups in the hub. It is not clear that this group could agree subsequently and simultaneously on how to deal with a now larger set of ‘difficult’ issues.
3. Act unilaterally: a spoke country could unilaterally cut tariffs to the rest of the world. Depending on the extent to which this occurs, such an initiative could offset the investment diversion effects. The spoke agreement would then be part of a transition to free trade, but an expensive one. With hindsight, ‘one giant leap’ to free trade is preferable to a couple of small steps.

Snape (1996a) discusses how the growth of hub and spoke mechanisms could lead to greater resistance to multilateral liberalization. He argues that each spoke country has

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<sup>14</sup> A simple, one sector, illustration of this process at work is air transport. This case, of international air transport where the hub and spoke approach has been pursued by the United States, highlights the manner in which spoke countries can end up at a disadvantage compared to the hub country. See Findlay (1997).



paid a price for its preferential access to the hub country. The spokes will resist further reductions of tariffs on an MFN basis which erode the value of their special deal on the sensitive products. This is the same sort of factor which drives the club of oligopolists to decide to stop admitting new members (Andriamananjara, 1999). For the same reason, the current spokes would also resist, if they could, admission of new members to the arrangement. The value of their preferential access is diminished. While an FTA involving a group of economies might involve all members in the negotiation of the terms of accession of new members, in the hub and spoke arrangement the spokes may have little say in the process of admission. At the very least, the trade policy of the hub becomes a point of potential conflict among current and prospective members of the arrangement.

If spokes did have some influence, they may seek to have new members come in with fewer and fewer benefits. This resistance may come not only from domestic interests in the spoke countries, but also from foreign investors who might have invested in a spoke country for the purpose of access to the hub. Those investors might even be investors originally from the hub country, and they will not be without influence in their old home.

In summary, the hub and spoke structure contains many risks. There are strong incentives for economies that are large enough to try to capture the role of hub economy, for example, in an attempt to dominate a group of complementary economies in their region. But doing so leads to a structure of layers of discrimination and potential conflict. Finally, as Wonnacott (1996) points out, there can also be offsetting foreign policy impacts for the hub. A hub economy that is already dominant in economic terms would be seen as trying to add to its position by biasing the rules of the new trading system in its favor.

## **NEXT STEPS**

Our main concern is therefore that the uncoordinated pursuit of a preferential approach to reform will lead to an inefficient outcome from the perspective of the group of economies. The situation calls for consideration of the scope to develop forms of cooperation to avoid this outcome. What are the options?

### **The WTO**

With respect to trade in goods, the GATT contains an article (XXIV) that specifies the principles to be met. There are processes in the WTO which review the agreements that are notified to it. The numbers of notified agreements and their growth were discussed above. So far, the WTO processes have been able to reach consensus on only a very small number.<sup>15</sup> What is the problem?

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<sup>15</sup> GATT Analytical Index (1995), p. 817 reports that "... the examination of agreements notified under Article XXIV:7 has almost never led to a unanimous conclusion or a specific endorsement by the CONTRACTING PARTIES that all the legal requirements of Article XXIV had been met and that the parties



Article XXIV says those members of a customs union or free trade area (or any interim arrangement leading to such arrangements) should not introduce 'higher or more restrictive' duties and 'the other regulations of commerce' in respect of trade with non-members. Furthermore, the article requires that 'duties and other restrictive regulations of commerce ...are eliminated on substantially all trade'. A definite timetable for implementation is also to be provided.<sup>16</sup> For developing economies, under Part IV, 1965 and the Enabling Clause, 1979, partial PTAs are allowed for one way preferences from developed to developing economies, and for two way preferences between developing economies. The latter puts less demanding conditions for creation of PTAs for developing economies and, as such, PTAs of developing economy membership, such as the ASEAN Free Trade Area, can stop short of becoming a real free trade area and have comparatively a limited coverage for liberalization beyond tariffs (Panagariya, 2000: 289).

Crawford and Laird (2000) provide a detailed discussion of the technical problems, including a review of background papers on the issues prepared by the WTO Secretariat (1998). Examples of the systemic issues include the following:

- the interpretation of the term 'substantially all trade' (for example, does this mean the share of trade, or coverage of sectors?),
- the definition of the term 'other regulations of commerce' regarding the extent of coverage regarding the extent of coverage (e.g. safeguards can still be applied with RTAs, but others are not mentioned specifically, such as anti dumping and countervailing duties, and thus raising the issue of the coverage of measures),
- the treatment of developing economies, and
- the treatment of transition periods and different time frames for implementation<sup>17</sup>, including interpretation of not raising trade barriers to non-members.

While the rules are not clear, the nature of the approval process adds to the stalemate.<sup>18</sup> So many members of the WTO are also members of preferential arrangements that when a decision has to be made on a particular agreement, none will vote in favor unless they are sure that later the parties whose agreement is approved will also

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to the agreement in question could claim the benefits of Article XXIV. The exceptions are the customs union between the Czech Republic and the Slovak Republic; the Caribbean Community and Common Market (CARICOM); the Caribbean Free Trade Agreement; and the El Salvador-Nicaragua Free Trade Area and the Participation of Nicaragua in the Central American Free Trade Area. In the case of the Ireland-United Kingdom Free Trade Agreement the conclusions stated that no recommendations were being made under Article XXIV:7." The Committee of Regional Trading Arrangements (CRTA) set up in 1996 have examined 86 (62 are in advanced stage of examination) out of the 220 RTAs notified to the WTO, but it has only approved one examination report for the submission to the General Council (i.e. the Czech Republic and Slovak Republic customs union).

<sup>16</sup> There is also scope to apply tariff preferences on a much more limited range of products under the so-called Enabling Clause. These agreements also do not require duty elimination, have no fixed timetables, and are not subject to periodic reporting. See Laird (1999)

<sup>17</sup> The Understanding on the interpretation of Article XXIV, which was included in the Final Act of the Uruguay Round provided that the "reasonable period of time" for establishing a free trade area should in normal circumstances not exceed ten years.

<sup>18</sup> A breakthrough in work on the clarification of the rules is a recent dispute panel decision on a preferential arrangement (the EU-Turkey case).

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support their own agreements. Apart from clarity on the rules, one way to deal with this issue may be to group agreements and make a decision on a block of blocs.

Similar problems arise in relation to service agreements. The relevant article in the GATS (V) says that groups of members can enter into an agreement liberalizing trade in services between or among themselves as long as it:

- has substantial sectoral coverage,
- provides for the absence or elimination of substantially all discrimination between or among the parties in the sectors covered.

There is also a requirement that the agreement should not raise the 'overall' level of barriers to trade in services with non-members compared to that before the agreement. Developing countries are provided flexibility for meeting the sectoral coverage condition when they are members of an agreement.

Again, there are questions about what is meant by substantial coverage. A footnote to the Article says that this requirement should be interpreted in terms of number of sectors, volume of trade affected and modes of supply and stresses that agreements should not provide for the a priori exclusion of any mode of supply. Even if the parameters could be agreed, that lack of data on trade and investment in services makes it difficult to implement any agreement.

Given the systemic issues and the lack of effectiveness of Article XXIV in setting up a system of RTAs, which are based on a set of principles and a clear framework, it seems unlikely that tightening of WTO rules on RTAs will only occur at very slow pace. Snape (1996a:60) notes further that even if the GATT conditions were met it could still be possible for there to emerge a network of preferential agreements which 'would harm the development of a truly multilateral and open trading system'. He suggested that these agreements could set out to be discriminatory, such as containing administrative arrangements, of the type discussed above, which increased distortions, even though more formal barriers to trade were reduced.

The problems are at two levels: first, in the interpretation of the rules on preferential agreements in the GATT and the GATS and, second, their relevance to resolving the problems of overlapping, or hub and spoke structures, of the new, or potential, preferential agreements.

There have been other suggestions for dealing with these issues. For example, a proposal in Snape, Adams and Morgan (1993), repeated in Snape (1996a), is that a regional agreement which involved trade preferences would be more likely to promote multilateral liberalization if it involved:

- Full liberalization of trade at least in all products if not also in productive factors
- No raising of external barriers to trade and investment on formation or subsequently, and a willingness and capacity to negotiate external barrier reduction after formation



- Openness to new members on conditions similar to those faced by existing members.
- Homogeneous rules of origin and dispute settlement procedures

The first of these conditions, rewritten today, would probably refer to services as well as goods. The second condition on the willingness and capacity to negotiate external barrier reduction after formation is important to reduce the trade diverting effects, and to reduce, even at formation, the investment diversion effects.

The results of Andriamananjara (1999) referred to above highlight the significance of both the second and third items. The result of his model is free trade if there is open membership and the presence of sequential decision making. In the presence of the simultaneous creation of trading blocs, there will be incentives to merge blocs and that process will continue to free trade as long as the inter-bloc tariff is low enough. As Andriamananjara (1999) puts it, a preferential integration path can lead to free trade if it is undertaken alongside or after the multilateral one so that the general level of MFN tariffs is low enough.<sup>19</sup> While these results come from a model with one industry, they highlight the value of these principles as a guide for the preferential reform process.

The fourth item on rules of origin is important in the light of the comments above. The nature of 'homogeneous' in the text above remains to be defined. Crawford and Laird (2000) stress that, at present, there are no WTO disciplines on rules of origin. There could be a single set of such rules to which agreement members sign on. At least there could be developed a set of reference rules which non-members could use as the basis of a complaint. A review of the existing set of rules and their scope for abuse could be the first step.

### **The role of APEC**

Are there mechanisms for review by peers (i.e. non-members) of preferential trade agreements, which will help, guide their development? Within the Asia Pacific, the APEC process is the obvious location for such a peer review process, and that work has begun. The APEC Ministers in their meeting in Darwin said "we believe that sub-regional trading arrangements should be consistent with WTO rules. We believe they should be in line with APEC architecture and supportive of APEC goals and principles." They noted the proposal by officials to survey existing agreements.

The APEC architecture to which the Ministers referred does have something to say about what are called sub-regional agreements. The Osaka Action Agenda provides for an accession arrangement. With respect to tariffs and non-tariff barriers it proposes

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<sup>19</sup> Air transport was used earlier as a simple illustration of the consequences of the hub and spoke approach to reform. One solution proposed in that sector has been called an open club model a feature of which is this accession arrangement. Elek and others (1999) present the details of that proposal which was taken up by the Productivity Commission (1998). Some APEC members have recently signed a plurilateral air transport agreement. The same sorts of accession rules are being considered within the APEC as a device for managing what might otherwise be the discriminatory effects of agreements on trade facilitation issues (e.g. customs clearance arrangements or business mobility).



a form of accession by suggesting that all members 'consider extending, on a voluntary basis, to all APEC economies the benefits of reductions and elimination of (these) measures derived from sub-regional arrangements'. Furthermore, the long-term goal of APEC is free and open trade and investment no later than the year 2010 in the case of industrialized economies and the year 2020 in the case of developing economies. The long-term commitment on external impediments, across the wide scope of the APEC agenda, would undo the discrimination within a sub-regional agreement. This effect is stressed in the new AFTA-CER study outlined above.

A more immediate opportunity is the scope for APEC to play a role in a breaking down the incentives for a preferential approach. APEC, through its programs of liberalization and facilitation, alongside capacity building, can contribute the confidence about multilateral liberalization among the membership. This avoids one of the problems of the effects of a lack of confidence in the prospects for multilateralism, which the McLaren (1999) model highlighted. It can also utilize this package approach combined with the unique peer review process to get economies back on track to undertake concerted unilateral reforms, and utilizing the Bogor goals as indicative targets.

The consultations APEC promotes can help reduce the concern about exclusion from preferential agreements. It is an informal forum where comment on the trade and investment diverting effects of such agreements can be raised. It could also provide a mechanism for the review of preferential agreements among its members, and for the application of principles such as open accession and a commitment to MFN tariff reductions.

### **Unbundle the issues**

Another possibility is to separate out the new issues and deal with them under separate agreements. This approach emerges from work by Elek (2000) on the issues in regional cooperation for dealing with the new non-border issues in trade policy where some negotiation on the terms of access to new arrangements is inevitable. Elek's proposal is that to deal with these new issues, there is no need to negotiate a package deal. Particular issues can be dealt with by separate arrangements. Sensitive issues in one area (e.g. agricultural market access) in that case need not delay work on others and a win-win situation is achieved (e.g. work on removing impediments to business mobility). Elek (2000) also discusses the principles that might be applied to these arrangements so that the dynamics created lead to a liberalizing outcome and he stresses the value of transparency, avoiding new obstacles, accession and the provision for review.

While these situations generate benefits for both parties, there is also some political economy difficulties in the negotiating process. Losing a benefit can also be a significant issue for policy makers, and negotiations can be impeded by debate on the distribution of the gains from these arrangements. Policy makers might like the package approach, because it gives them more scope to point to benefits to the interests



they need to mobilize in order to drive reform at home. A package is also valuable in a negotiating framework.

Further, there is the tendency to use these sorts of barriers to create closed markets, as we noted above in relation to standards. In that context, a commitment at the foundation stage to terms of accession is critical. Higher level organizations like APEC can then play an important role in monitoring the constitutions of these sorts of structures.<sup>20</sup>

## **CONCLUSIONS**

A series of factors including combination of business pressure and policy entrepreneurship have contributed to the proliferation of interest in preferential trading arrangements in East Asia. This represents a significant shift in thinking about trade policy strategy in the region. While only one new agreement has actually been signed, there is plenty of activity, including negotiations in process. Some of these negotiations are taking longer than the initiators may have wished. It is not clear that the results will be those expected, and the process of negotiations has highlighted the issues associated with negotiated access to sensitive sectors. Further, the initiators of the recent burst of bilateral activity tend to be the more highly developed economies in East Asia and they tend to look to each other for new bilateral partnerships. Others, such as the ASEAN members, are already members of arrangements.

Where will this higher level uncoordinated international economic policy-making take us? We have noted the possibility that it may actually come to not much at all. But suppose there does emerge a string of new agreements. The conditions under which the process will take us to a more liberal regime overall are tough to meet. They include specification of the terms of accession, of symmetry in arrangements, including coverage, and the commitment to multilateralize preferential tariff cuts. It is not plausible, therefore, that the uncoordinated pursuit of the preferential route to reform can lead a desirable outcome from the perspective of the region as a whole. On the contrary, the outcome could be a policy-making disaster for East Asia.

The key conditions, however, give us some guidance on the directions to take in building a cooperative regime that at least tries to reduce the risk of a bad outcome for everyone, particularly those excluded from the new proposals. These conditions are not unheard of. The AFTA members, for example, who apart from Singapore are not joining the rush to enter into bilateral agreements, are participating in an agreement which is becoming deeper and which has some features of the targeted conditions, including MFN liberalization and accession.

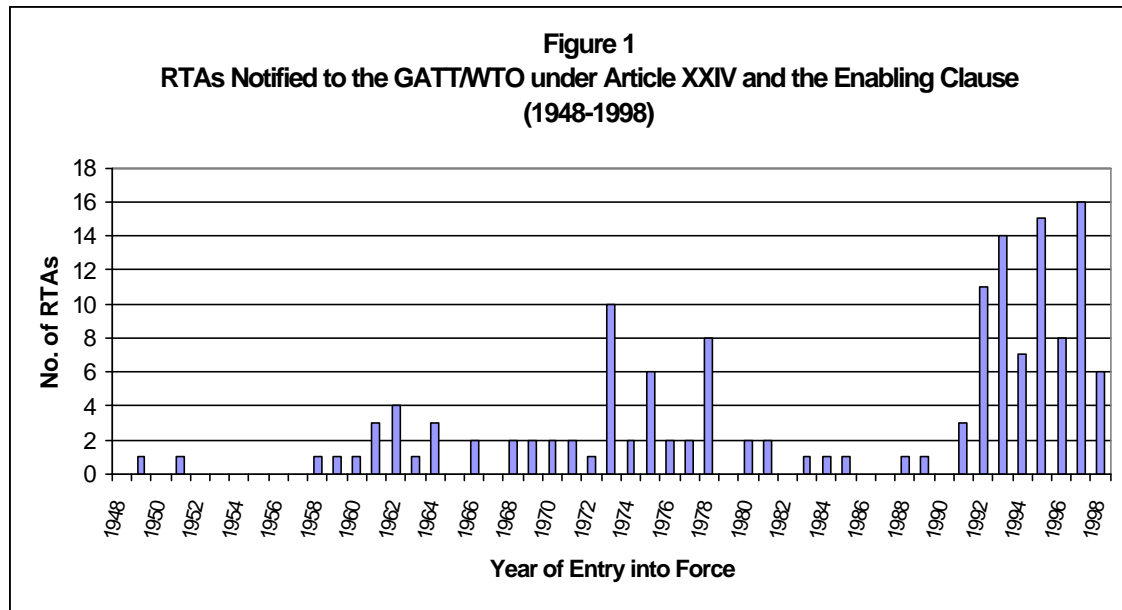
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<sup>20</sup> There are also WTO reference points for these sorts of specialized agreements, e.g. the language on mutual recognition in the TBT agreement, and the 'open club' approach adopted in the services negotiations on accountancy (see Snape, 1996a).

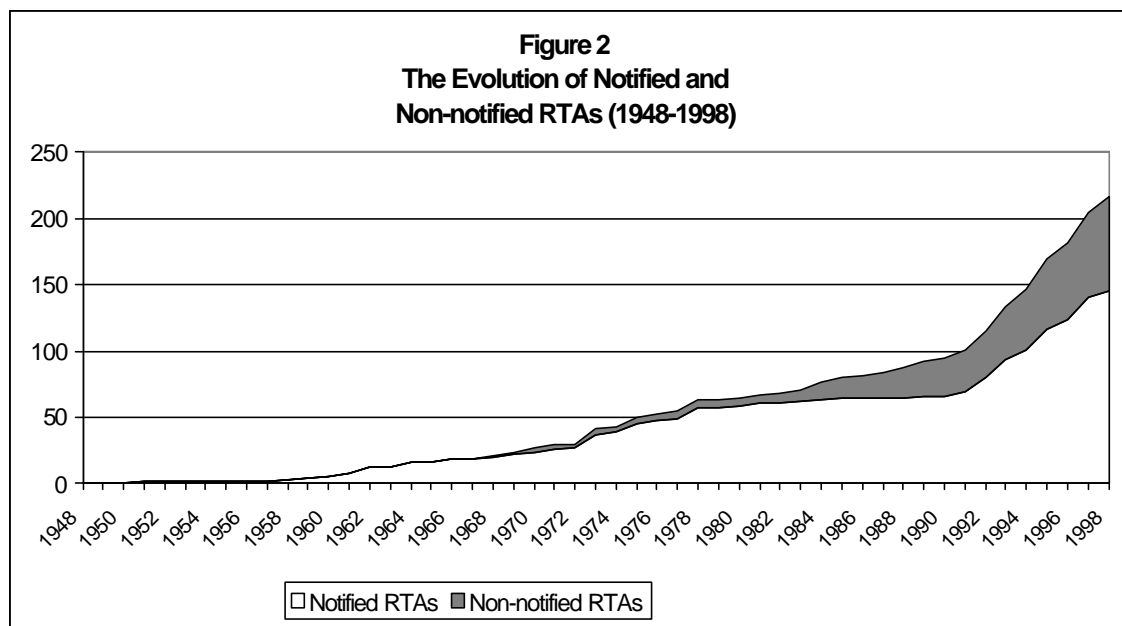


Are the institutions in place to provide this cooperative outcome? We suggest that the solution will have to involve commitments on rules and process, which exceed those required in the WTO. APEC, we suggest, provides a good forum to consider these conditions and to monitor their adoption. We also outline a proposal to disaggregate the issues and deal with them at different speeds, rather than in a package. Options are available, and the next challenge is to work out how they fit together in the regionalism portfolio.





Source: WTO (1999)



Source: WTO (1999)



**Table 1: Merchandise imports of members of selected preferential trading arrangements, 1990 to 1998**

Agreement	Trade flow	Value in 1998 (\$USB)	Share in total imports		Growth rate 1990-1998
			1990	1998	
EU	Intra-	1233	63.2	60.0	2.9
	Extra-	822	36.8	40.0	4.7
NAFTA	Intra-	509	33.3	40.2	11.0
	Extra-	757	66.7	59.8	7.0
AFTA	Intra-	50	14.3	19.4	10.7
	Extra-	209	85.7	80.6	5.7
CER	Intra-	5	7.4	6.7	3.3
	Extra-	65	92.7	93.3	4.6
Mercosur	Intra-	21	14.5	21.2	22.0
	Extra-	78	85.5	78.8	15.2
Andean	Intra-	5	6.8	11.7	20.6
	Extra-	40	93.2	88.3	11.9
<b>World Trade</b>		5600			6.2

Source: International Economic Data Bank, Australian National University

**Table 2: Import and export intensities of selected preferential trading arrangements 1990 and 1998**

Agreement	Trade flow	Import intensity		Export intensity	
		1990	1998	1990	1998
EU	Within group	1.38	1.49	1.45	1.67
	With row	0.68	0.67	0.63	0.61
NAFTA	Within group	2.09	2.23	2.19	2.29
	With row	0.79	0.73	0.72	0.62
AFTA	Within group	3.38	3.30	3.99	4.18
	With row	0.89	0.86	0.86	0.85
CER	Within group	5.35	5.95	5.20	6.74
	With row	0.94	0.94	0.94	0.93
Mercosur	Within group	10.23	14.10	10.49	14.26
	With row	0.87	0.80	0.92	0.76
Andean	Within group	7.01	16.44	8.32	17.91
	With row	0.94	0.89	0.96	0.86

Source: International Economic Data Bank, Australian National University

Row = rest of the world



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**APPENDIX: DEVELOPMENTS IN PREFERENTIAL TRADING ARRANGEMENTS AMONG SELECTED APEC MEMBERS.**

**Singapore/NZ:** A new FTA is designed on the blueprint of the NZ/Australia CER, but the agreement is viewed as an open document in which other economies can participate. It was signed on 14 November 2000, just before the APEC Leaders meeting in Brunei. Coverage of the agreement includes goods (with parts on tariffs and NTMs), services, investment, customs procedures, standards, government procurement, intellectual property and dispute settlement. The rule of origin for goods requires 40% ex-factory cost threshold for goods partly manufactured in either economy, plus a requirement that the last process of manufacture is performed in the exporting economy. That for services refers to the presence of substantive business operations in either economy. Anti-dumping provisions are retained. There is however explicit commitment to effort to adopt the “APEC Principles to Enhance Competition and Regulatory Reform.”

**AFTA/CER:** A High-level Task Force on the AFTA-CER Free Trade Area made recommendations for consideration by Ministers on whether and if so how to proceed with an AFTA-CER arrangement. The report of the group entitled “The Angkor Agenda” was presented to the ASEAN Economic Ministers and the Ministers from the CER economies at their consultations on 6 October 2000. According to the official reporting the work is to proceed in the hands of officials. The extent of the political commitment to the proposals from the ASEAN side, however, remains uncertain, reflecting the sensitivity of some sectors including autos in moving faster with selected trading partners. A press release by Australian Trade Minister Mr. Vaile of the 6<sup>th</sup> of October stressed that the work had now moved to a government-to-government level, from a non-government process. The features of the Task Force proposal included the following:

- A new arrangement would be separate from either AFTA or CER, both of which would continue to exist.
- The new agreement would be comprehensive.
- Its program of liberalization would not normally be faster than AFTA (in which the commitment is zero tariffs for the ASEAN-6 by 2010 and for the 4 newer members by 2015).
- The new agreement would be faster than APEC.
- The discussion of the joint arrangement would be open to new issues, e.g. e-commerce, but in these cases members of either group could decide to exclude themselves temporarily.
- There would be flexibility for new ASEAN members.
- The joint agreement would be open to accession by others.

**Australia/Singapore:** Australia and Singapore announced a commitment to begin negotiations on a free trade agreement on 15 November 2000.



**Singapore/Mexico:** Singapore and Mexico first discussed the idea for an FTA during the Auckland APEC Leaders' Meeting. Negotiations for an FTA began in July 2000 and officials have met four times. A Joint Declaration on the agreement was signed in November 2000 and this provided the detail of what had been agreed so far and what needed to be done. Progress was slower than expected. When the negotiations began, it had been hoped they would have been completed by this time.

**Singapore/US:** The second round of negotiations on a Singapore-US FTA was held in January 2001. The first was in December and there was a fact-finding mission by the US to Singapore in January. The visit covered competition policy, textile and customs enforcement and labor issues. The timing of the start of the third round depends on the new US Administration. There is a commitment to establish an FTA that covers substantially all trade.

**Korea/Japan:** During a visit March 1999 by Prime Minister Obuchi to Korea, it was proposed to establish the 'Japan-Korea Economic Agenda 21', the coverage of which appeared to be a new investment treaty, a new tax treaty, cooperation in standards and conformance, an agreement to work on intellectual property issues and further talks leading up to the WTO Ministerial. The broad goal of this program was to 'solidify (the) bilateral economic partnership'. This agenda was interpreted and extended, apparently on their own initiative, by research groups in Korea and Japan to include an examination of the feasibility of a bilateral FTA. The model these groups have studied is comprehensive, including not just tariffs but also rules and standards, investment, and other trade facilitation matters. A summary of the research completed was released in May 2000. In September, 2000, the Korea and Japan adopted the South Korea-Japan IT Cooperation Initiative. The meeting in which that agreement was adopted also set up a Korea-Japan business forum to collect opinions on an FTA. There is also some reporting of a separate "investment pact" between Japan and Korea with references to completing in during the year 2000.

**Singapore/Japan:** A proposal was made in December 1999 by Prime Minister Goh and accepted by Japan to study and negotiate an agreement encompassing facilitation issues and some service sector issues. A report by a Joint Study Group was released in September 2000. The first round of negotiations took place in January 2001, and the target is to complete the discussions by the end of the year. There are also reports that the discussions are focused on goods, services, investment and movement of people. The Joint Study Group report (paragraph 9) indicates that Japan 'was not prepared for further tariff reduction in (agricultural, forestry and fishery) sectors' and there is then reference to the issue of meeting the conditions of the WTO of covering substantially all trade. The hope is expressed that this issue could be resolved during any subsequent negotiations.

**Japan/Canada:** Japan's Ministry of Trade and Industry commissioned a study of the bilateral Canada and Japan relationship (Dobson, 1999). The Canada-Japan Trade Council came out with its own study (Holroyd, 2000). These studies considered the options for bilateral cooperation. The context is the future of Canada's relationship with the United States, including the evaluation of options such as common external tariffs or



common currency. There is also some expectation that a free trade agreement with Japan might maintain market access in East Asia if that region pursues its own 'bloc' but there are also issues related to sensitive sectors, such as the auto and machinery industries in Canada and fishing interests in. More recently Hart (2000) produced a report on the relationship for the Canada-Japan Business Council. Hart argued that "a conventional free trade agreement is not best suited to tackling the issues that stand in the way of increased bilateral trade and investment. Rather, ....free trade makes more sense as the ultimate objective of a more focused and creative strategy that includes, as an important short-term goal, the development of greater confidence in the two business communities that freer trade can make a real and sustainable difference." (p. iii).

**Korea/Chile:** Negotiations between Korea and Chile on a free trade agreement are in progress. Sensitive issues include Chilean exports of agricultural products. Cheong (1999) reviews Korea's position and identifies some sensitive sectors. "In order to successfully prepare for the signing of FTAs, the Ministry of Foreign Affairs and Trade (of Korea) has organized and is running five working groups and 14 sub-groups consisting of some 120 officials and experts from 15 ministries, 10 research centers, business firms and other organizations." The 4th round of Korea/Chile negotiations was held in December 2000. There are 4 working groups on market access, services and investment, rules of origin and other issues including government procurement and competition policy.