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## **ADB Working Paper Series**

### **The Emerging “Post-Doha” Agenda and the New Regionalism in the Asia-Pacific**

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**Abstract**

This paper considers emerging commercial policy challenges facing the Asia-Pacific region in light of the impasse reached at the Eighth World Trade Organization (WTO) Ministerial Meeting in December 2011. It underscores that, while marginal liberalization of trade barriers under the Doha Development Agenda may not be forthcoming in the short- or even medium-term, the WTO has been successful in erecting a rules-based system of global governance and continues to be extremely important to the future health of the international trading system. Nevertheless, one can expect the current trend toward bilateral and regional free-trade areas (FTAs) will continue, particularly since it is easier to make progress toward “deep integration” in a smaller group of like-minded countries than in the context of the general WTO membership. This paper considers how the FTA trend is developing in the Asia-Pacific region and what its prospects are in the future. It stresses that regional—as opposed to bilateral—arrangements will be essential to the region for economic (e.g., supporting regional production networks) as well as diplomatic-political goals. This “new regionalism,” which has been supported by Asia-Pacific Economic Cooperation (APEC), will lead to significant reductions in the costs associated with bilateral FTAs (e.g., lower costs associated with rules of origin, improved utilization rates) and has many advantages over “noodle-bowl” bilateralism.

**JEL Classification:** F13, F15

In this paper, “\$” refers to US dollars.

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## 1. INTRODUCTION

As of 15 January 2012, the WTO reports that, counting goods and services separately, it has received over 500 notifications of regional trading arrangements (RTAs, defined by the WTO to be a reciprocal trading agreement between two or more countries), with 319 in force.<sup>1</sup> This number is up from 300 at the end of 2005 and 130 at the beginning of 1995 (Plummer 2007). Asia has been a major participant in this rapid increase in RTAs; in fact, apart from the ASEAN Free-Trade Area (AFTA) in 1992, no Asian country had a significant RTA in place prior to 2000, whereas as of January 2012 there were 99 Asia-related RTAs signed and in effect and another 151 at various stages of negotiation.<sup>2</sup> Many of these arrangements are intra-regional; Appendix Table 1 gives an inventory of these arrangements for the East Asian Summit (ASEAN+8) economies. Clearly, Asia has embraced regionalism in a big way.

At the multilateral level, however, the situation is mixed. On the one hand, the WTO system itself is functioning well, with the rule-based system being respected, a much-improved dispute settlement mechanism (over the GATT) in place, and rising membership (with Russia likely to join this year). The WTO continues to be the pre-eminent institution of global government of trade. On the other hand, the multilateral liberalization process appears to be stalled, with the Doha Development Agenda (DDA) negotiations and attempts at other deliverables (e.g., duty-free/quota-free market access for least-developed economies; elimination of “nuisance tariffs”; an agreement on trade facilitation) generally fruitless at the 8<sup>th</sup> WTO Ministerial Meeting in December 2011. Moreover, the WTO agreement itself has been criticized for not including (or covering insufficiently) a number of trade-related issues that, some argue, need to be addressed at the multilateral level in the 21<sup>st</sup> Century, e.g., export restrictions, competition policy (“competitive neutrality”), environmental-related measures (e.g., “environmental” dumping), and, of course, issues related to exchange-rate “manipulation.”

On the positive side, perhaps in 2013 or later there will be a new impetus to multilateral liberalization, either under the form of a rejuvenated DDA or in other ways, but much will have to change (and some proposals could be problematic). We discuss these problems in Section 2. Nevertheless, regionalism is the most important force in international commercial policy today and it will likely continue to be so in the foreseeable future. Hence, we consider whether regionalism is an inherent threat to the multilateral system (Section 3) and anticipate what we believe will be the “new regionalism” in the Asia-Pacific (Section 4). Section 5 offers some concluding remarks.

## 2. MULTILATERALISM AFTER THE EIGHTH WTO MINISTERIAL CONFERENCE

Relative to previous negotiating rounds, the DDA has been characterized by far greater participation of developing countries, which have raised their expectations as to what they hope to receive from developed countries in terms of liberalization of certain labor-intensive, but especially agricultural, goods.<sup>3</sup> Developed countries, on the other hand, pressed, *inter alia*, for deeper cuts in industrial tariffs in developing economies. This has given the impression of

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<sup>1</sup> WTO website, [www.wto.org](http://www.wto.org), accessed 19 March 2012.

<sup>2</sup> [www.aric.adb.org](http://www.aric.adb.org), accessed 18 July 2012.

<sup>3</sup> Part of this section draws from Plummer (2012).

“North-South” tension at the DDA and has been blamed for the 2011 impasse, an impasse that will continue at least until mid-2013.

No doubt, the differences between the negotiating stances of the “North” and the “South” were in evidence throughout the entire DDA negotiations. This is, perhaps, quite predictable: negotiators focus on improving market access and facilitating the development of comparative advantage industries. For the North, this means concentrating on higher-value added manufactures; financial and other services; protection of intellectual property; and investment and trade facilitation, which facilitate foreign direct investment (FDI) flows. The South, on the other hand, naturally focuses on labor-intensive manufactures and resists liberalization of its most sensitive areas, as well as behind-the-border measures that may infringe on national sovereignty.

However, the situation is far more complex: negotiating stances are not completely dictated by North-South differences. Developing countries have become more active at Doha because most have now embraced an outward-oriented development strategy and depend on the international marketplace to enhance growth and development. In the past, these countries were not active at GATT rounds, as they generally chose to “free-ride” on commitments between developed countries from which they also received MFN benefits. The cost of this approach became evident in time: the sectors that were being liberalized were of principal interest to developed, rather than developing, countries. In order to include comparative-advantage sectors of the developing world, a pro-active stance at the WTO was necessary, and these economies did have an overlap of interests *vis à vis* developed economies.

Still, the world is changing rapidly, and it is too simplistic to evaluate trends in commercial policy based on this traditional North-South divide. The share of emerging markets in global economic activity has been rising significantly; for example, Asian economies constituted 28% of the global economy in 2010, up from 8% in 1980, and this share is projected to rise to 40% in 2030 and 52% in 2050 (ADB 2011). Other key emerging markets, such as Brazil, Russia, and South Africa, have also been experiencing a much greater presence in global markets. Whereas in the past GATT rounds were dominated by Northern initiative without a large role for the South, this is certainly no longer the case. In this sense, one might say that the impasse at the DDA has been a sign of maturity of the organization, with a more symmetric distribution of power... and responsibility.

In fact, there are also tensions across emerging market economies. Trade across the “BRICS” (Brazil, Russia, India, the Republic of China [PRC], and South Africa) has been rising considerably and productive and export structures between most of them (in particular, Brazil, India, and the PRC) are far more similar than, say, those of the key developed countries at the negotiating table at the DDA. *Ceteris paribus*, we would expect that political interests in these economies would be at least as sensitive (but, most likely, more sensitive) to competition due to liberalization under the DDA from fellow BRICS than from developed economies. A textile-producing country fears competition from another textile-producing country more than from a country that produces automobiles. Arguably, trade patterns are reinforcing these sensitivities. For example, the PRC’s trade with other developing economies has been growing by leaps and bounds in recent years; indeed, the share of its trade with non-Asian developing economies is the most dynamic in its trade portfolio (ADB 2012). This trade tends to be dominated by the PRC’s exporting manufactures in exchange for natural-resource-related goods. The reaction in other BRICS has been negative, with some fearing that this could be a new manifestation of “dependencia,” which in turn has given wind to the sails of some domestic protectionist interests. Coupled with the fact that the BRICS are cast as leaders of the developing world and standing up to developed economies may be perceived as a manifestation of leadership credentials, the DDA may have been facing more than just headwinds from economic issues.

If indeed these political-economy issues are important determinants of the emerging market negotiating stance, we might have to wait a long time for the DDA (or any other single-undertaking under the WTO) to be completed.<sup>4</sup> Perhaps recognizing this, policymakers have been exploring opportunities outside the single-undertaking, for example, in the area of “plurilaterals.”

Currently, there are two prominent, quite successful plurilaterals under the auspices of the WTO: the Information Technology Agreement (ITA) and the Government Procurement Agreement (GPA).<sup>5</sup> The ITA has 70 participating parties that constitute 97% of the pooled markets of WTO membership in included products. The ITA focuses exclusively on tariffs, which are bound at zero, and benefits are applied on an MFN basis. The GPA includes 15 economies (taking the European Union [EU] as only one member) and its benefits are not applied on an most-favored nation (MFN) basis but rather are only accorded to its membership, though any WTO member has a right to join (there are currently 22 observes, with nine currently negotiating accession, including the PRC).

As a single-undertaking has proven so difficult, it is only natural that policymakers are considering less ambitious approaches by focusing on sectors. To the extent that these accords grant MFN to all parties, there is no reason to believe that they could potentially damage the multilateral system. I note potentially because, arguably, an agreement like the GPA does not create distortions related to “trade diversion”; prior to the agreement, preferences generally were given to domestic producers and, hence, the GPA increased competition between domestic firms and foreign (GPA-member) firms, rather than across foreign competitors (who were previously discriminated against anyway). However, to the extent that such a plurilateral could lead to new discrimination across members, it could create some serious problems.

To begin, if a plurilateral does not include substantially all goods (as required for the Article XXIV or the GATS Article V exceptions), it would violate Article I of the WTO. For example, there has been some talk of proposing an “ITA II,” which would expand significantly product coverage, and to make it reciprocal without requiring the 90% minimum as required with the first ITA agreement. If the developed economies were to table an expansive list of additional products that would be considered excessive from the viewpoint of India and the PRC, a reciprocal ITA II would simply exclude them, with potential for trade diversion and arguably a violation of MFN. Some might note that they could join later if they wished, but an exception under Article XXIV does not allow for this. Moreover, these kinds of single-sector accords could have significant negative implications for effective rates of protection.

Another plurilateral approach would be to require reciprocity but meet the “substantially all goods” requirement. Such an idea was tabled at the Eighth Ministerial in the area of services, where the GATS Article V would also require that most services sectors be included in any accord. In theory, this would be a very interesting approach; in practice, it could create problems. First, “substantially all goods” has never been appropriately defined. The GATT saw, for example, a number of FTAs in manufactures alone (arguably not “substantially all goods”) and even bilateral free trade in one sector between the US (US) and Canada: the 1965 agreement on auto parts. A limited set of services included in such an agreement would have the potential for negative, “second-best” ramifications and reflect poorly on the WTO itself. Second, who will join such an agreement? If it is only Organisation for Economic Co-operation and Development (OECD) countries, it could exacerbate the impression of a North-South divide in the WTO. Currently, the momentum for a services plurilateral is coming from the 18 “Really Good Friends

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<sup>4</sup> Hufbauer and Schott (2012) are also skeptical of future progress at the DDA and propose moving away from a single-undertaking toward a “Grand Bargain” as a more effective way of moving the process forward.

<sup>5</sup> The third WTO plurilateral relates to trade in civil aircraft.



of Services,” comprised mostly of OECD economies and including none from the BRIC group (*Geneva Watch* 2012).

In sum, the DDA will likely be stalled for some time, and more modest approaches to multilateral liberalization will themselves probably be limited (and could, and least in principle, create worrying precedents). As the regionalism trend emerging in full force in the early 2000s side-by-side with DDA negotiations, we can expect that it will be the only game in town for at least the next few years (and, most likely, longer).

### 3. ON BUILDING BLOCS AND STUMBLING BLOCS

Disillusionment with progress at the DDA may be one reason for the proliferation of regional agreements in Asia and the rest of the world. The ambitious agenda of Doha, from both developed- and developing-country viewpoints, could be more easily managed bilaterally or between a small group of countries than in an organization of 157 highly-divergent economies. Hence, it is no mystery as to why many of the new regional agreements are between developed and developing countries: what is needed to integrate global markets further, from non-tariff barriers to behind-the-border issues, may be too much to handle at the WTO.

The WTO is cognizant of the regionalism trend and understands the problems that it could potentially entail for the global trading system (See, for example, WTO 2011). Indeed, the challenges of regionalism to the WTO are many, but two in particular stand out. First, the General Agreement on Tariffs and Trade (GATT)/WTO was created with MFN treatment as its over-riding principle, and Article XXIV was to be a conditional exception to this rule. With so many accords in place and every major economy participating in at least one FTA (and most in many), what happens when the exception becomes the rule? How valid is the coveted MFN, a birthright of WTO membership, when regional trading arrangements erode it and, in essence, force countries into regional trading arrangements in order to *retain* MFN status? Second, as we will argue below, regionalism is not necessarily in conflict with multilateralism, subject to the principle of openness and the minimization of the inefficiencies and potential discrimination inherent in regional agreements.

In this section, I will first discuss some of the problems associated with the “regionalism debate,” beginning with some introductory observations and followed by a summary of the “building blocs versus stumbling blocs” debate itself.<sup>6</sup>

#### ***a. Introductory Comments Regarding Regionalism versus Multilateralism***

It is important to note first of all that, while WTO accords do impose a certain symmetry, they do not guarantee it. For example, the WTO sets out rules of behavior in terms of anti-dumping that are no doubt superior to a system void of rules. But they do not harmonize all anti-dumping practices. Member-states continue to have a great deal of flexibility in this regard (and probably always will have, at least in the context of the WTO). Moreover, the lack of across-the-board inclusion of sectors and asymmetric liberalization within the context of GATT/WTO liberalization could create distortions that exacerbate effective rates of protection; that is, while regionalism discriminates across *countries*, the GATT/WTO discriminates across *sectors*, and to the extent that this is the case, both are second-best. The existence of a WTO Valuation Agreement on customs is extremely useful but there continues to be considerable variation in terms of adopted practices across WTO member-states. The same can generally be true of “Singapore issue”-

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<sup>6</sup> Some of this discussion is adapted from Plummer (2008).

related topics, intellectual property right (IPR) protection, and the like, in which the WTO often has little or incomplete jurisdiction. A salient disadvantage of the multilateral approach under the WTO is that harmonization of such rules and policies has proven to be extremely difficult, and progress highly limited, due to the diversity of its membership, as well as disagreements as to how comprehensive the mission of the WTO should be. Given that the organization of the international economy (e.g., via production networks) has become more complicated and reaches ever-deeper into the very fabric of domestic policy and legislation, behind-the-border issues are becoming increasingly important. These, though, are even more difficult to include in negotiations among a membership with widely-diverging interests and positions regarding an outward-oriented development strategy.

The usefulness of regional agreements—and certainly one reason for their popularity (see World Bank 2005, Kreinin and Plummer 2002, Frankel 1998)—lies in their ability to drive integration and cooperation in areas that have hitherto been neglected by the WTO, e.g., in terms of tariff, non-tariff and behind-the-border measures. Thus, while it is true that a multilateral approach would dominate a bilateral/regional strategy if all the same measures are included and harmonized/liberalized to the same extent, it is not a dominant strategy once we relax this (unrealistic) assumption of symmetry in liberalization and coverage.

In fact, critiques of FTAs relative to free trade can easily fall into “straw man” analysis. For example, the rules of origin constraints under North American Free Trade Agreement (NAFTA) in automobiles (62.5%) and certain textile products (effectively 100%) do not fit the criteria for “open regionalism” under any definition of this term. However, these are probably among the most obvious out of relatively few such divergencies in what is in reality a liberal agreement. Besides, for NAFTA, the effective benchmark should be the *status quo*, not *free trade*. Would auto and textile imports to the US have been much less restrictive without NAFTA? Not necessarily. In fact, certainly trade diversion does have costs, but we cannot say that NAFTA closed those markets, since failure to meet NAFTA rules of origin meant recourse to the *status quo*. The *status quo* did not become more protective; in textiles and apparel, the US market has become *more* open with the expiration of global import quotas on January 1 2005 (under Uruguay Round commitments). Again, Mexican textiles receive preferential treatment and, hence, trade diversion is a cost to be borne by non-partners and US consumers, but there still is an associated trade creation effect that would have not occurred had there been no NAFTA. Net gains have been estimated to have been positive.<sup>7</sup>

Many American economists supported NAFTA not for general support for regionalism *per se* or their belief that it would have great effects on allocative efficiency in North America through the liberalization of tariff and non-tariff barriers, which were, after all, low in the aggregate.<sup>8</sup> Effects on the US and, especially, Canada, were estimated to be positive but small. Rather, it was supported in the main because it would lock in the Mexican economic reforms leading up to NAFTA and would set the stage for further liberalization. Given the history of economic volatility in Mexico, NAFTA as a “policy anchor” was deemed to be extremely useful. Once NAFTA began to be implemented in full force (i.e., after the Mexican crisis in December 1994, which had little or nothing to do with NAFTA directly), the net effect on macro performance in Mexico has been very positive (Kose and Rebucci 2005). In 2005, the US government gave a high priority to an FTA with Central America (“CAFTA”) in hopes that it would have the same stabilizing effect.<sup>9</sup>

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<sup>7</sup> See, for example, Hufbauer and Schott (2005).

<sup>8</sup> These were higher in the case of Mexico, but as Mexico is a small economy compared to the US and Canada, the net effects could not be large.

<sup>9</sup> It is interesting to note that CAFTA was passed in the US only after personal lobbying by the President himself, and then the pact passed by only a two-vote margin in the House of Representatives. But Congressional opposition was

And while the percentage of total Mexican trade has risen to somewhat over three-fourths (from two-thirds) in the wake of NAFTA, a result of both trade creation and diversion, one cannot say that Mexico has been “captive” in NAFTA. In fact, Mexico now has negotiated some 39 FTAs. Moreover, openness of the Mexican economy has allowed non-partner countries to benefit; the financial sector in Mexico, for example, is characterized by a considerable European presence. Again, this is not to argue that restrictive rules of origin and other inward-looking clauses in regional trading arrangements do not constitute a problematic aspect of RTAs. A consistent, liberal, across-the-board rules of origin policy is the least distortionary in a second-best world (Plummer 2007). But we should not exaggerate its absolute importance in the regionalism debate.

Moreover, time *and* depth matter. Many protagonists of a purely multilateral approach to economic cooperation tend to present arguments without a well-defined time horizon. But time is important when considering the present discounted value to national welfare of a regional trading accord compared to multilateral free trade. A heuristic example may help underscore this point. Suppose Indonesia has an option to create an FTA with the US, but its leaders know that this will have some costs in terms of trade diversion. The “first-best” (global free trade) policy, its leaders might reckon, would ultimately be the best deal for Indonesia, as non-discriminatory free trade would have no trade diversion and could maximize trade creation. But since Indonesia is unable to benefit from global free-trade (no such option exists at present), timing becomes an essential factor in the policy decision. If global free trade were an option in the very short term, then, *ceteris paribus*, free trade would be better than the deal with the US. But what if the FTA with the US were possible today, and yet global free trade would take 5 more years? Which would be better? It would depend on what the Indonesia-US deal would look like (relative to the global deal), but nevertheless, it could be that free trade would still be worth the wait. But what if free trade were to take more like 20, 30, or 40 years? After all, the GATT/WTO has existed for over a half-century, and global free trade is nowhere in sight. Of course, this type of analysis will be a function of the type of regional accord, in particular if it is inward-looking or outward-looking. If it were the former, the deal with the US could end up being very much to the detriment of Indonesia. As we shall see in terms of the “building bloc versus stumbling bloc” debate, the type of agreement is of the essence. But it would also be important to know what the multilateral deal would be. If a regional accord entailed far more reforms *vis a vis* market-friendly, efficient policies at macro and micro levels whereas global free trade meant merely the abolition of tariff barriers, the former could still potentially be as good or better than the latter.

Herein lies the attraction and, in many ways, advantage that regionalism holds over multilateralism: *it allows like-minded countries to address far more issues and in a shorter period of time*. By choosing one or several like-minded partners, countries are able to make more progress in terms of deep integration than they could in the extremely-diverse WTO context. Rising interest in regionalism on the part of OECD countries that traditionally had shunned them (the US, Japan, the Republic of Korea) derives from their desire to address these many issues and their understanding that they cannot accomplish them in the context of the WTO, or at least not in the short/medium run. A successful conclusion to DDA would, perhaps, have had an impact on the momentum behind the regionalism movement, but this is not guaranteed: the incentives for new bilateral/plurilateral accords, as well as for deepening existing ones, would remain. Besides, the DDA is stalled and, as noted above, may well be so for some time in the future.

What is guaranteed through successful multilateralism is a reduction in the potential negative effects of these regional agreements and overall less risk to the integrity of the international

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not due to a dislike of regionalism per se but rather a dislike of trade liberalization, that is, it was generally opposed on traditional protectionist grounds.

trading system. Moreover, to the extent that a multilateral accord can, indeed, make Article XXIV more effective in ensuring that these new regional agreements will be outward-looking and consistent with a WTO approach, the risks associated with regionalism could be significantly mitigated (Plummer 2007). Economists should continue to support a “deep” DDA.

Hence, the obvious question emerges as to how regional agreements themselves can work in favor of global free trade. The traditional approach is to view it from the “building blocs versus stumbling blocs” lens, which we do below.

### ***b. Building Blocs versus Stumbling Blocs: Theoretical Considerations***

Does regionalism support unilateral/multilateral reform goals, or does the discrimination inherent in a trade bloc lead to a “second best” outcome at best, or an inward-looking one at worst? This is the essence of the “building blocs” versus “stumbling blocs” debate. The literature would suggest that several possible negative policy consequences could emerge from an FTA, i.e., inherent “stumbling bloc” tendencies, while other tendencies would be consistent with multilateral goals and market-friendly domestic liberalization and could actually facilitate multilateral liberalization, that is, “building blocs.” Briefly, these would include<sup>10</sup>:

#### **i. Stumbling Blocs:**

1. *Maximizing terms of trade.* Regional integration, particularly customs unions, increases the size of an economic zone and, as such, increases market power. The potential benefits of exploiting such an advantage by imposing an “optimal tariff” (i.e., maximizing the difference between the terms of trade gains from a tariff regime against its costs in terms of efficiency) are familiar from the international trade literature. Moreover, FTAs and customs unions, by “virtue” of the trade diversion effect, improve their terms of trade relative to the rest of the world; the larger the grouping, the larger the potential improvement in the terms of trade.

In reality, the first effect is probably not particularly relevant, as even tariff regimes in the context of a customs union are not erected according to optimum tariff rules.<sup>11</sup> Moreover, in the cases of both customs unions and FTAs, changes in the external tariff regime cannot on average be more protective than the pre-integration *status quo*, according to Article XXIV. This does not mean that there will not be any potentially negative sectoral effects, but in this case GATT/WTO members are able to sue for compensation. The most famous case in this regard is, “Turkey: Restrictions on Imports of Textile Products,” in which India initiated a GATT panel against Turkey in the wake of the harmonization of its external tariff with the EU when it formed a customs union in manufactures (Herzstein and Whitlock 2005).<sup>12</sup> Of course, this effect would be even less important with improved rules within the context of Article XXIV.

With respect to the terms of trade effect, since trade diversion undeniably results from preferential trading arrangements, it is certainly a concern. But trade diversion is actually a one-

<sup>10</sup> See the classic piece by Frankel (1997), from which some of these topics are adopted.

<sup>11</sup> Nor are they at the country-level. While the optimum tariff argument is one of the three classic economic arguments in favor of protection (the others being the infant-industry argument and strategic trade policy), it is well recognized to be a theoretical argument. Tariffs are generally implemented for political and political-economy-related reasons, not as a means of trying to extract terms of trade gains.

<sup>12</sup> The Turkey case may be the most famous but there are others. For example, while Spain’s external tariff regime became more liberal after it joined the EC, the country did raise protection on agriculture imports in order to harmonize its policies with the EC’s Common Agricultural Policy. The US was able to extract compensation from the EC in the feed-grains sectors in compensation for the associated trade diversion.

time price effect and, hence, static in nature. In fact, it is *the* static cost of preferential trading accords.

2. *Manipulation of the contents and scope of the agreement by special interests.* This concern obviously also manifests itself in the context of domestic policy formation. Deardorff (2004) stresses that this is especially a problem in the context of developed-developing country accords, in which the former obviously have the upper hand, as special interests tend to be far better organized and funded. The lack of rigor and coverage in Article XXIV makes this a particular problem, as the flexibility allowed in an FTA tends to give considerable liberty to special-interest influences. Of course, this could also have a positive effect: special interest groups in developed countries no doubt push for better IPR protection, competition policy, treatment of FDI, and better trade and investment facilitation, but these arguably could have important positive effects on efficiency and policy formation in developing countries.<sup>13</sup>

3. *Waste of scarce negotiating resources.* Particularly (but not exclusively) in the case of developing countries, the scarcity of well-trained and well-experienced experts on trade negotiations imply that the opportunity cost of resources devoted to regional agreements is the allocation of less talent to multilateral deals. Critics of regionalism suggest that such a capacity constraint can only be detrimental to multilateral liberalization, and even well-developed domestic policy reform. For example, after Viet Nam joined the Association for Southeast Asian Nations (ASEAN) in 1995, it worked not only to enter into AFTA (due for completion in 2006) but also to implement a number of other accords, including an extensive Bilateral Trade Agreement (BTA) with the US in 2001. On top of that, it was working on ASEAN+3 initiatives and, eventually, the AEC. Given its human-capital capacity constraints, this could very well have delayed its drive to join the WTO.

Or, perhaps, not. A counter-argument would be that Viet Nam has been able to ready its economy for the WTO through the outward-oriented policies adopted because of its membership in ASEAN, and the BTA itself was essentially a means of preparing Viet Nam for WTO entry, including legal and administrative reforms that would in any event be necessary. The agreement is replete with references to WTO protocols and WTO-consistent reforms, from services liberalization to TRIPs-Plus. These negotiations have also sharpened the expertise of vietnamese negotiating authorities. The US also allocated a relatively large project (the “STAR Project”) to assist Viet Nam in reforming its legal system to be more compatible with international norms, as well as train officials.

## ii. Building Blocs.

1. *Lock in policy change.* We have referred to this effect fairly frequently in previous sections, using in particular the case of Mexico in NAFTA. But there are many others, including the case of Viet Nam, mentioned above, which has been able to use regional integration as a blueprint for market-friendly reform to become more competitive in the international marketplace. Without ASEAN (and eventually the BTA), one can easily argue that Viet Nam would have not made as much progress (and its joining the WTO would no doubt have been further delayed).

2. *Improve negotiating power for smaller units.* Traditionally, the possibility of small countries joining together and working as one cohesive unit in trade negotiations has always been recognized: even Harry Johnson, who was an avid critic of regionalism, acknowledged this potential benefit. This would apply both to smaller countries as well as larger units, such as the EU. Hence, in theory, ASEAN should be able to have much more power in influencing WTO

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<sup>13</sup> It should be noted that IPR is probably the most controversial in term of the ultimate effect on economic efficiency.

negotiations, or bilateral/regional/plurilateral deals in general, as a group: the whole could be greater than the sum of its parts.

The EU has certainly been effective in this regard from its beginning as the European Economic Community. But it began as a customs union, not merely an FTA, in which national commercial policy *vis a vis* third countries can differ (often substantially). ASEAN, however, has never been very effective at projecting its power as a unified group, even after AFTA. The region is just too diverse at this point and the interests of individual countries diverge too much (perhaps this will change with the AEC). Thus, we could probably conclude that this potential “building bloc” is theoretically a possibility, but in practice can be somewhat difficult, being a function of the type of accord (FTA or customs union) and the interests of the component states.

3. *A dynamic weeding process as a first step toward free trade.* It could very well be that the process of structural adjustment unleashed by a regional trading arrangement through trade creation could, in effect, make multilateral accords easier. As the weakest (and, hence, more resistant to any international competition) are weeded out due to, say, an FTA, the stock of opposition to trade falls in importance, thereby making multilateral initiatives easier.

Perhaps an example would illustrate the point. Suppose that the trade policies of a country (let's call it “home”) are determined by domestic firms, and “home” trades with two other countries: “partner” (i.e., the country that would ultimately form an FTA with “home”) and “rest of world.” Furthermore, assume that, in autarky, there are six industries, with linear cost structures of the firms in the home country being such that two are globally competitive (goods A and B), two (goods C and D) are competitive only regionally (in a potential FTA with “partner”), and two would never be competitive with trade (goods E and F). Now, assume that the “home” government puts to vote whether or not the country should move to free trade. Firms producing A and B will vote yes, as they would benefit from a larger market, but the other four firms would vote against it, as they would be put out of business. We remain in an autarkic equilibrium. But suppose now that the home country votes on whether or not it should have an FTA with “partner.” Goods A, B, C and D will vote in favor, and E and F against. The FTA would pass. Eventually, competition from the partner country will force out production of goods E and F in the home country (trade creation), and there will be no trade diversion (as we began in autarky). The remaining firms in the home country will, therefore, eventually only produce A, B, C and D. Next, assume that the home country votes once again on whether or not it should have free trade. The votes will now be two in favor (A and B) and two against (C and D). Assuming that consumers have even a little say would be sufficient to usher in free trade, and this would be due to the FTA “stepping stone” process.

4. *Competitive liberalization to attract international capital, as well as a positive “threat.”* Regional integration can be used as a means of rendering the component economies more efficient, competitive, and market friendly. While a grouping may or may not adopt global “best practices” in regulatory, legal, and other issues, it can reduce the stock of divergencies across countries (thereby making it easier to integrate globally). By reducing transaction costs across countries, an FTA can enhance its attractiveness to multinationals. As policy externalities become increasingly important as an FTA “deepens,” the incentive to internalize them through monitoring, sharing information, and closer cooperation increases. Because trade and financial links are becoming increasingly appreciated, countries within an FTA soon find it useful—or even necessary—to further financial and macroeconomic cooperation.

It may also be true that regional agreements can be used as implicit and explicit “threats,” particularly since FTAs seem to have a tendency to grow over time. An obvious example was the boost that President Clinton gave to Asia-Pacific Economic Cooperation (APEC) in 1993, when it invited leaders to Blake Island, Washington, for the first APEC Heads of State Summit. Strengthening the organization was supported at Blake Island, and the political will to move

forward on economic cooperation, especially in trade, was obviously in evidence (in the following year, in Indonesia, this would manifest itself in the “Bogor Vision” goals of open trade and investment by 2010 for developed economies and 2020 for developing economies). Prior to Blake Island, the Uruguay Round had failed to be approved twice (in 2000 and again in 2002) essentially because the EU and the US, backed by the Cairns Group, could not reach an agreement on agriculture. After the Blake Island Summit, the Europeans decided to sign the agreement. Many experts have stressed that Clinton deliberately used APEC as a “threat” to Europe, i.e., if the Uruguay Round didn’t go through, the US was perfectly willing to move forward on free trade with Asia. Rather than face trade diversion in the world’s most rapidly growing market by far, the EU opted for the GATT.

Each of these arguments has *theoretical* merits. But in practice, the inclination of the regional accord tends to be extremely important. Clearly, if the group is being formed as a means of enhancing inward-looking development strategies or as a way of isolating the region from global competition, this initial policy thrust would set in motion many of the problems discussed above. In fact, this approach has led to the downfall of many regional trading agreements in the past, especially in Latin American (e.g., the Latin American Free Trade Area).<sup>14</sup> Yet, if outward-looking economies form a regional grouping, it is likely that regionalism will serve to promote the goals of domestic policy reform and multilateral liberalization. This is due to at least four factors: (1) it is unlikely that a country wishing to promote outward-looking policies, including extensive unilateral liberalization and active participation at the WTO, would contradict this stance in favor of a regionally-closed system; (2) reductions in trade barriers within a preferential trading arrangement make it more attractive for a country to reduce external barriers, in effect “MFN-izing” regional concessions, because the most important cost of regionalism is trade diversion and lower external barriers will reduce associated costs; (3) the “weeding out” of least competitive industries (discussed above) and making the political economy of trade liberalization more favorable over time seems to have been important empirically<sup>15</sup>; and (4) the membership of RTAs tends to expand and to become more diverse over time, thereby reducing regional sources of support for protectionism in a particular country and industry, as well as reducing the overall potential for trade diversion. One might add to this the list of non-traditional benefits for developing countries in regional trading agreements such as enhanced macroeconomic stability via cooperation, greater FDI inflows and attendant technology transfer, structural policy change and reform, and state-of-the-art harmonization. The lion’s share of empirical estimates of the economic effects of regional trading agreements in East Asia, for example, using either CGE modeling or econometric methods, reveal net trade creation.

In sum, while the risks of regionalism are real and, as with any real-world second-best policies, costs exist, it would appear that what is driving the regionalism movement since the early 2000s, particularly in Asia, is based on an outward-looking approach to integration and that the implications have been positive for the region. AFTA and other expressions of ASEAN integration are exemplary of this. Still, minimizing costs is of the essence. In Plummer (2007) I suggest a framework under which this might be done; additional ideas are found in WTO 2011 and “multilateralising regionalism” work forthcoming from the OECD.

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<sup>14</sup> It is not clear that much has changed in Latin America: MERCOSUR, which is a customs union between Brazil, Argentina, Paraguay, and Uruguay, has often been reluctant to open certain markets domestically (e.g., automobiles) and the customs union itself has over 1,000 exemptions.

<sup>15</sup> Perhaps it would be more accurate to say “anecdotally,” as the empirical literature on this subject is not well developed.

## 4. THE NEW REGIONALISM IN THE ASIA-PACIFIC

There have been many excellent surveys of regional economic integration in Asia (e.g., ADB 2012, ADB 2008, Kawai 2005). Several factors influencing the regionalism trend in East Asia stem directly from the Asian Financial Crisis, including: (1) the obvious contagion relationships, which demonstrated the policy externalities across countries in ASEAN and the NIEs; (2) major disappointment with respect to the Western reaction to the Crisis, leaving the feeling of “being in it alone together”; (3) disappointing progress in APEC in achieving closer trade and financial cooperation, as well as development assistance cooperation; (4) Japan’s offer to create an Asian Monetary Fund during the Crisis—opposed by the IMF and the US—gave the impression that Japan wanted to be pro-active in the region; (5) arguably, the PRC’s decision not to devalue during this period also created a sense of solidarity; (6) the “New Miyazawa Plan,” launched in October 1998 which dedicated \$30 billion to help spur recovery in East Asia (and deemed highly successful)<sup>16</sup>; and (7) the policies promulgated by the IMF to solve the Crisis were deemed inappropriate, giving greater credibility to the “Asian approach.”

Hence, the Crisis itself set the stage for serious and durable East Asian regionalism. There are many other internal and external forces at work that have expedited the process, such as the rise of regionalism globally and its potential negative effects on the region; the successful example of the Single Market Program in Europe; general pessimism regarding what can be achieved at the WTO in light of failure to move forward at the Seattle and Cancun WTO Ministerials; and the potential inherent benefits of FTAs. Importantly, bringing down barriers to economic interaction in order to lure FDI and promote production networks has certainly been a key factor in the ever-expanding intra-regional (Table 1) and extra-regional ([www.aric.adb.org](http://www.aric.adb.org)) agreements. Nevertheless, I would suggest that the next wave of regionalism will be in favor of regional accords, rather than the plethora of bilateral FTAs that constitute the “Asian noodle bowl.”

A strong majority of the RTAs concluded or initiated by Asian economies were bilateral FTAs, which tend to be easier to negotiate than, say, larger memberships or deeper accords such as customs unions. Moreover, a majority of these FTAs are with economies outside of Asia. Thus, when Asian governments consider bilateral accords, they think globally, rather than just regionally. These priorities reflect the driving forces behind regionalism in Asia, which tend to be *economic* rather than political. Indeed, this might distinguish Asia from bilateral and regional accords elsewhere, which tend to be politically dominated. For example, early integration initiatives in Europe, beginning with the Coal and Steel Community and the European Economic Community, had strong political backing (integrating France and Germany after the World War II, Cold War exigencies), even though the economics were somewhat dubious at the time. Even monetary union in the EU was made possible due to political reasons, that is, post Cold War incentives and, in particular, facilitating the political integration of East and West Germany. In fact, the need to support economic integration in Asia is even helping to overcome some of the most difficult obstacles to cooperation in the region; a decade ago few if anyone could have foreseen that the PRC, the Republic of Korea, and Japan would be able to improve relations sufficiently to sit down and negotiate an FTA. Yet, that is exactly what was agreed to at their May 2012 Summit, with negotiations perhaps beginning as early as November 2012.

If this thesis that Asian regionalism is based on economics is correct, then the creation of regional accords would certainly emerge as a more efficient approach than bilateral FTAs. While the vast majority of empirical studies on bilateral FTAs in Asia would suggest that these accords

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<sup>16</sup> Kawai (2005).



have had (or will have) a positive effect on welfare of their member-states, with small negative effects on the rest of the world in terms of trade diversion, they clearly have important shortcomings (as noted above). But most importantly: ***if the driving force behind regionalism in Asia pertains to international and regional production networks, bilateral FTAs will tend to fall short.*** Regional FTAs would be needed to optimize regional production networks and lower costs associated with, for example, rules of origin (via cumulation), and outward-oriented regional FTAs that minimize discrimination against non-partners and have open membership clauses would facilitate international production networks.

We might call the realization of the need to create regional FTAs the “new regionalism” in Asia. Creating these regional institutions that will facilitate the integration of the region over the medium-long term will no doubt be high on the agenda of most Asian policymakers in years to come. We might consider two “pathways” in this regard: one East Asian, the other Pacific Rim.

To begin, in 2004 the ASEAN+3 Economic Ministers commissioned a study of the feasibility of an East Asia FTA (EAFTA), and this idea has gained prominence in recent years. With the likelihood of PRC+Japan+Republic of Korea negotiations for an FTA starting this year, a Northeast Asian FTA would make an ASEAN+3 FTA relatively easy, since each of the Three has an FTA with ASEAN (and the EAFTA would, therefore, be a question of consolidation). There has also been support for the creation of a “Comprehensive Economic Partnership in East Asia” (CEPEA), which would be composed of the ASEAN+3, Australia, New Zealand, and India (ASEAN+6).

The Trans-Pacific Partnership (TPP) agreement negotiations have also been gaining momentum since they were launched in 2008. The TPP builds on a high-quality FTA between four small, open economies (Brunei Darussalam, Singapore, New Zealand, and Chile), known as the “P4,” and in addition to these negotiators the TPP includes the US, Australia, Malaysia, Viet Nam, and Peru (the “TPP 9”). At the APEC Summit in Honolulu in November 2011, Japan, Canada, and Mexico expressed their interests in eventually entering negotiations. On the sidelines of the G-20 Heads of State meetings in Los Cabos, Mexico, Canada and Mexico were invited to join the TPP negotiations (the Japanese application has not yet moved forward). In July 2012, the TPP concluded its 13<sup>th</sup> Round in San Diego, US, with the objective of trying to finish by the end of 2012.

The TPP is distinct not only in terms of the large differences in levels of development (from low-middle-income developing countries like Peru and Viet Nam to high-income, advanced OECD members like the US and Australia) but in terms of its ambitions to become a “21<sup>st</sup> Century” agreement that would embrace a wide-variety of areas, from trade in goods and services to science and technology and small- and medium-sized enterprises, including many difficult-to-negotiate behind-the-border measures. Its membership is technically open to any APEC member; indeed, its ultimate goal is the creation of a “Free-Trade Area of the Asia Pacific” (FTAAP) that would include all APEC members. Both the EAFTA and TPP “tracks” were cited by APEC at its 2010 Summit in Yokohama as paths to the creation of an FTAAP. Clearly, there is a good deal of membership overlap between the EAFTA and TPP economies.

Petri, et al. (2011) use an advanced Computable General Equilibrium (CGE) modeling approach to estimate the economic impact of the “Asian track” (EAFTA) and the “Transpacific track” (TPP) as pathways to the FTAAP. The Asian track assumes a PRC, Japan, Republic of Korea FTA in 2012 and then an EAFTA (ASEAN+3) in 2015; for the Transpacific track, they assume a TPP9 agreement in 2012 and an expansion in 2015 to include Japan, the Republic of Korea, Canada, and Mexico. They assume that both tracks eventually lead to an FTAAP that would begin in 2020. They estimate fairly large gains for both tracks: the effects on the world economy would be small initially but by 2025 the annual welfare gains would rise to \$104 billion on the TPP track, \$303 billion on both tracks, and \$862 billion with an FTAAP. Interestingly, the biggest gains

accrue when the two tracks are consolidated; in effect, this results from both the PRC and the US being included in the same agreement.

As of this writing, the outlook for a PRC, Japan, and Republic of Korea FTA (and, hence, an EAFTA within several years) and the TPP9—or even the TPP11—seems fairly bright within the next year or two. And should each of these tracks begin implementation in the short-run, the medium-term goal of an FTAAP would seem much more within reach. The literature is replete with arguments as to why the FTAAP will not be reached for various reasons, prominent among them being US-PRC trade relations. But it is worth underscoring that the PRC and the US are big economic winners in the FTAAP scenario in Petri et al. (2011). Success in this regard would be consistent with the diplomatic and political goals of both countries, and eight years is a long time in trade policy.

## 5. CONCLUSIONS

We can summarize the main conclusions of this study as follows:

1. A strong, vibrant WTO is essential to the prosperity of the international trading system.
2. Still, it is important to note that the prospects for significant liberalization scenarios under the WTO in the near future are not bright. The ten-years-plus DDA single-undertaking is on hold (again) and will likely not start up again until mid-2013 at the earliest; other possible liberalization approaches (e.g., “plurilaterals”) are possible but, again, difficult and fraught with potential problems, depending on how they develop.
3. While a multilateral approach to trade policy is best *ceteris paribus*, regionalism does have a number of advantages in that it is able to achieve more progress in a shorter period of time within the context of a group of like-minded countries. Global free-trade is not an option at present (or likely in my lifetime, and I hope to live a long time), and even if it were what could be tackled at the multilateral level with 157 (and growing) diverse economies in the WTO context would be far less than what can be achieved within a regional grouping.
4. Of course, if regionalism is “closed,” it will be detrimental to the global trading system. We survey the issues related to the “stumbling bloc versus building bloc” debate and suggest that while FTAs do have potential drawbacks and that the essence of the agreement will be a key determinant, FTAs can, indeed, be building blocs, particularly if the orientation of the integrating economies is outward in nature, as in the case of Asia. A continued emphasis on outward-orientation, minimizing discrimination, inclusiveness and embracing the first-best needs to be made in order to ensure that regionalism in Asia (and elsewhere) serves to enhance competitiveness and support global free markets, rather than detract from them.

Finally, we also note that while regionalism is usually compared to multilateralism in the literature, insufficient attention is, perhaps, placed on the inefficiencies of bilateral FTAs relative to regional ones. We stress that regional arrangements are of the essence in the Asia-Pacific region for economic (e.g., regional production networks) as well as diplomatic political goals. This “new regionalism,” which has been supported by APEC, will lead to significant reductions in the costs associated with bilateral FTAs (e.g., lower costs associated with rules of origin, improved utilization rates) and seems to (rightly) be receiving a good deal more attention.

A successful conclusion to the TPP negotiations this year will likely increase the incentives of Northeast Asian economies to work together with Southeast Asian economies to build the EAFTA in the near future. If both of these Asian and Asia-Pacific tracks are concluded, the Asia-Pacific region will be well on its way to a Free-Trade Area of the Asia Pacific (FTAAP) beginning in 2020, which was articulated at the November 2010 Yokohama APEC Summit as the ultimate

goal of the region's trade cooperation. This process could also potentially draw in other economies, e.g., in South Asia (India) and in Latin America.

Now, an APEC-only FTAAP itself, with over 60% of global GDP—let alone an FTAAP that includes additional members—would be sufficient to create concerns as to the future of the global trading system. Such concerns need to be allayed by emphasizing in word and deed that Asia-Pacific cooperation is about open regionalism and supporting the global system, rather than creating a competitor to it. That might take some doing. But in the meantime, it could well be that, as in the case of the Uruguay Round and the Blake Island Summit of APEC in 1993, the successful Asia-Pacific integration process could revitalize global negotiations well before 2020. All that is certain is that trade policy over the next decade will be interesting.

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APPENDIX TABLE: FTA PARTNERSHIPS IN EAST ASIAN SUMMIT COUNTRIES

	Australia	New Zealand	ASEAN	Brunei Darussalam	Cambodia	Indonesia	Lao PDR	Malaysia	Myanmar	Philippines	Singapore	Thailand	Viet Nam	PRC	Japan	Republic of Korea	India	US	Russia
Australia		CERTA/ AFTA/ SPECA	AFTA	AFTA	AFTA	AFTA	AFTA	AFTA	AFTA	AFTA	AFTA/ FTA	AFTA/ FTA	AFTA					FTA	
New Zealand	CERTA/ AFTA/ SPECA		AFTA	AFTA/ TSEPA	AFTA	AFTA	AFTA	AFTA/ FTA	AFTA	AFTA	AFTA/ TSEPA/ CEP	AFTA/ CEP	AFTA	FTA					
ASEAN	AFTA	AFTA	AEC	AEC	AEC	AEC	AEC	AEC	AEC	AEC	AEC	AEC	AEC	ACECA	ACEPA	ACECA	ACECA		
Brunei Darussalam	AFTA	AFTA/ TSEPA	AEC		AEC	AEC	AEC	AEC	AEC	AEC	AEC/ TSEPA	AEC	AEC	ACECA	ACEPA/ FTA	ACECA	ACECA		
Cambodia	AFTA	AFTA	AEC	AEC		AEC	AEC	AEC	AEC	AEC	AEC	AEC	AEC	ACECA	ACEPA	ACECA	ACECA		
Indonesia	AFTA	AFTA	AEC	AEC	AEC		AEC	AEC/ PTA-8*	AEC	AEC	AEC	AEC	AEC	ACECA	ACEPA/ EPA	ACECA	ACECA		
Lao PDR	AFTA	AFTA	AEC	AEC	AEC	AEC		AEC	AEC	AEC	AEC	AEC/ PTA	AEC	ACECA/ APTA	ACEPA	ACECA/ APTA	ACECA/ APTA		
Malaysia	AFTA	AFTA/ FTA	AEC	AEC	AEC	AEC/ PTA-8*	AEC		AEC	AEC	AEC	AEC	AEC	ACECA	ACEPA/ EPA	ACECA	ACECA/ CECA		
Myanmar	AFTA	AFTA	AEC	AEC	AEC	AEC	AEC	AEC		AEC	AEC	AEC	AEC	ACECA	ACEPA	ACECA	ACECA		
Philippines	AFTA	AFTA	AEC	AEC	AEC	AEC	AEC	AEC	AEC		AEC	AEC	AEC	ACECA	ACEPA/ EPA	ACECA	ACECA		
Singapore	AFTA/ FTA	AFTA/ TSEPA/ CEP	AEC	AEC/ TSEPA	AEC	AEC	AEC	AEC	AEC	AEC		AEC	AEC	ACECA/ FTA	ACEPA/ EANP	ACECA/ FTA	ACECA/ CECA	FTA	
Thailand	AFTA/ FTA	AFTA/ CEP	AEC	AEC	AEC	AEC	AEC/ PTA	AEC	AEC	AEC	AEC		AEC	ACECA/ FTA	ACEPA/ EPA	ACECA	ACECA		
Viet Nam	AFTA	AFTA	AEC	AEC	AEC	AEC	AEC	AEC	AEC	AEC	AEC	AEC		ACECA	ACEPA/ EPA	ACECA	ACECA		
Northeast Asia																			
PRC		FTA	ACECA	ACECA	ACECA	ACECA	ACECA/ APTA	ACECA	ACECA	ACECA	ACECA/ FTA	ACECA/ FTA	ACECA			APTA	APTA		

Japan			ACEPA	ACEPA/ FTA	ACEPA	ACEPA/ EPA	ACEPA	ACEPA/ EPA	ACEPA	ACEPA/ EPA	ACEPA/ EANP	ACEPA/ EPA	ACEPA/ EPA				CEPA		
Republic of Korea			ACECA	ACECA	ACECA	ACECA	ACECA/ APTA	ACECA	ACECA	ACECA	ACECA/ FTA	ACECA	ACECA	APTA			CEPA/ APTA	FTA*	
India			ACECA	ACECA	ACECA	ACECA	ACECA/ APTA	ACECA/ CECA	ACECA	ACECA	ACECA/ CECA	ACECA	ACECA	APTA	CEPA	CEPA/ APTA			
US	FTA										FTA					FTA*			
Russia																			

**\*Signed but not yet in effect.**

ACECA	ASEAN-Comprehensive Economic Cooperation Agreement (ASEAN-PRC, ASEAN-Rep. of Korea, ASEAN-India)
ACEPA	ASEAN Comprehensive Economic Partnership Agreement
AEC	ASEAN Economic Community
AFTA	ASEAN-Australia and New Zealand Free Trade Agreement
APTA	Asia-Pacific Trade Agreement
CECA	Comprehensive Economic Cooperation Agreement
CEP	Closer Economic Partnership
CEPA	Comprehensive Economic Partnership Agreement

CERTA	Closer Economic Relations Trade Agreement
EANP	Economic Agreement for a New-Age Partnership
FTA	Free Trade Agreement
PTA	Preferential Trading Agreement
PTA-8	Preferential Tariff Arrangement - Group of Eight Developing Countries
SEPA	Strategic Economic Partnership Agreement
SPECA	South Pacific Regional Trade and Economic Cooperation Agreement
TSEPA	Trans-Pacific Strategic Economic Partnership Agreement